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MORTGAGE BANKING

NOVEMBER 1986

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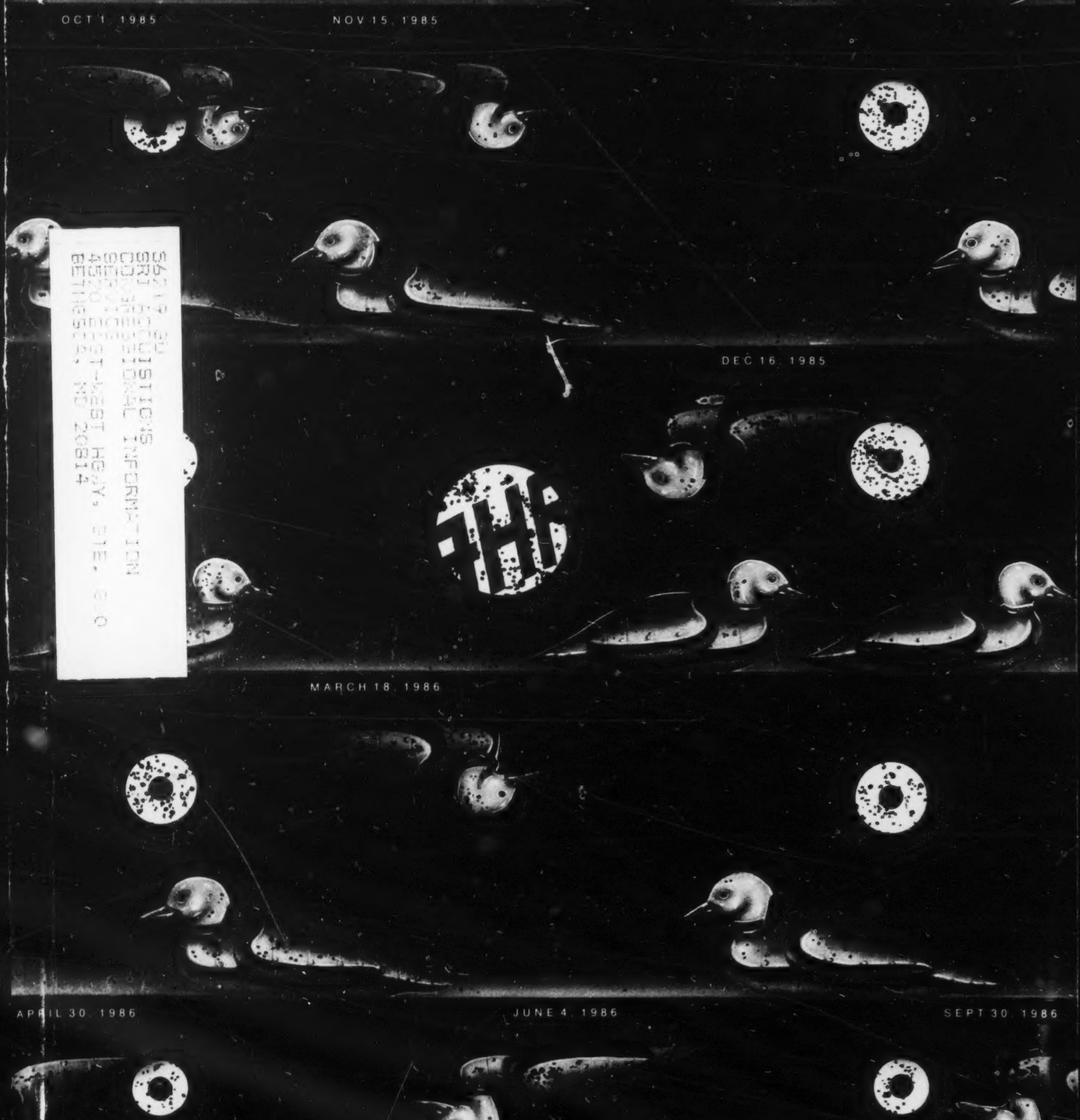
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MORTGAGE BANKING

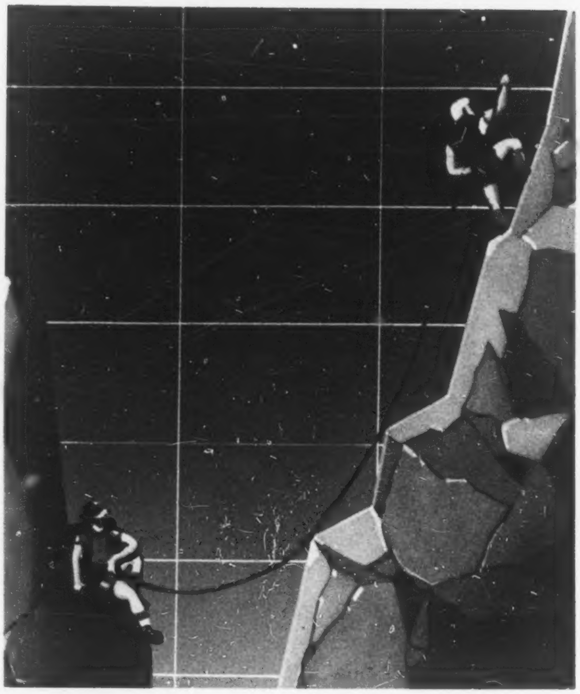
VOLUME 47 NO. 2
NOVEMBER 1986

ARTICLES

PAGE 10
AN INTERVIEW WITH THOMAS FRENCH
MBA's incoming president examines the real estate finance industry and outlines the issues his administration will concentrate on in the coming year.

PAGE 20
FHA: HOUSING AFFORDABILITY FOR THE BUTCHER, BAKER AND CANDLESTICKMAKER
The Honorable Henry B. Gonzalez
Established in 1934 to enable lower- and middle-income families with an opportunity to buy a home, the Federal Housing Administration continues to be an essential element to homeownership for Americans. Congressman Gonzalez believes that FHA will be the key to housing affordability in the future.

PAGE 28
HATS OFF FOR THE VA PROGRAM
The Honorable Richard Shelby
Congressman Shelby explains how Congress is committed to a viable ongoing housing program for veterans. Those who seek to diminish the program's effectiveness, privatize it or end it altogether will learn that the opposition is formidable.



PAGE 39
REMIC: AN IDEA WHOSE TIME HAS COME
Brian D. Cooney
This instrument is expected to increase the availability of mortgage money at reduced interest rates and prove helpful for the secondary mortgage market and the American homebuyer.

PAGE 46
ASSET SECURITIZATION: DREAM VEHICLE
Mark Korell and David McGowan
Securitization is a means for reducing pressure on capital accounts and costs of capital and a prevention for receivables from growing too fast. All these advantages spell increased profit for your organization.

PAGE 62
BUSINESS BASICS—DEFAULTING CONSTRUCTION LOANS: WHAT'S WRONG WITH THIS PROJECT?
Paul D. Snyder
When a construction loan starts to go sour, the lender should start making inquiries to determine what went wrong along the way. This article provides a useful approach to the situation.

PAGE 73
EVALUATING SERVICING PORTFOLIOS: WHICH COST TO USE
John W. Starke and Michael K. Stamper
This article addresses the question of which cost of servicing to use for evaluating servicing portfolios. During the past several years, some servicing valuations have used average cost and some have used incremental cost.

PAGE 84
COMMERCIAL SERVICING PORTFOLIOS: DETERMINING PEAKS AND VALLEYS
Anita Sweeney and Russ Smith
Several methods or considerations necessary for evaluating commercial mortgage servicing portfolios are analyzed. If commercial loans are valued right along with residential loans significant errors can result.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 62
PEOPLE 98
SECONDARY MORTGAGE MARKETS 103
MORTGAGE MARKET TRENDS 105
AD INDEX 118

MORTGAGE MARKET TRENDS

A surge in consumer spending, largely induced by cut-rate auto financing, led to a marked improvement in the rate of economic growth in the third quarter. The actual figure should be in the 2½ percent range, a vast improvement over the anemic 0.6 percent recorded for the second quarter.

The fourth quarter should see a slight improvement in economic performance, fueled by a pickup in auto production as dealers seek to restore depleted inventories and continued strong gains in consumer spending, though not at quite the brisk pace of the third quarter. However, sluggish growth in the 2 percent range can be expected to characterize the first half of 1987 due to a slowing in the rate of increase of consumer spending, the effects of tax reform and a slowdown in the rate of growth of federal spending. As a result, interest rates should remain near current levels for the remainder of the year and edge downward in early 1987.

Although recent monthly employment gains have been disappointing, implying a slowing of the rate of growth of personal income, consumer spending is expected to remain strong in the fourth quarter. Consumers have shown a willingness to add to their installment debt and reduce their savings rate in order to take advantage of recently available purchasing incentives. Some of this strength is expected to carry forward into the fourth quarter, especially for the larger durable items such as autos, furniture and appliances. The elimination of the sales tax under the new tax bill provides an incentive to "move up" purchase plans to 1986. However, the effects on growth of the increased demand for consumer durables will be mitigated by the fact that a significant portion of the increased sales can be expected to consist of imported goods.

The moving up of spending on consumer durables in the current quarter, in which sales are borrowed from early 1987, is expected to contribute to a significant weakening of consumer spending in the first half of the upcoming year. In addition, consumers can be expected to replenish their recently depleted savings and to work off some of their debt burden during this period.

The industrial sector continues to show signs of weakness. Industrial production, up 0.1 percent in August compared with July, is only 0.3 percent above the level of a year ago. Manufacturing employment appeared to show some signs of stabilizing earlier in the summer. However, revised figures show that employment in this sector is continuing its declining trend. In addition, new orders for non-defense manufactured goods, the dominant and more stable component of the new orders measure, has been flat in recent months. There are, however, some reasons for being optimistic. A rise in auto production can be expected in order to replenish inventories and in response to continued strong demand. Also, the recent Purchasing Manager's Survey suggests some expansion in production in the near term. However, stabilization or modest growth in this sector appears to be the best that can be expected through the first half of 1987.

Recent surveys indicate very little growth in planned business fixed investment over the next six months. The phasing out of the investment tax credit, together with a relatively low rate of capacity utilization and high vacancy rates in commercial buildings, could result in weakness in this area for an extended period of time.

Inventory investment can be expected to provide some stimulus to growth in the months ahead. Both retailers and manufacturers appear to be remaining cautious in regard to inventory accumulation, after having to offer price concessions to move large stocks of inventories recently. However, a significant increase in auto inventories can be expected in the fourth quarter as dealers replenish their currently low stocks. This controlled inventory growth now should prevent any serious overhang of inventories from dampening economic growth in early 1987.

The expanding trade deficit, which has been a major drag on economic growth during the past two years, is not expected to show much, if any, improvement in the near term. In fact, while the level of petroleum imports can be expected to decline in the fourth quarter, increases in non-petroleum imports and a decline in exports of manufactured goods could result in a further deterioration of the trade deficit.

Now that the effects of the oil price declines earlier in the year have largely worked their way through the system, the rate of price increase can be expected to return to trend levels. Thus, we anticipate an inflation rate of roughly 4 percent at an annualized rate through the first half of 1987.

The Federal Reserve, concerned about recent signs of weakness in the economy, is expected to continue its accommodative stance. But it is unlikely that economic developments will induce the Fed to lower the discount rate again this year. However, a further cut in the discount rate early in 1987 is a strong possibility.

Interest rates should remain in their current range through the final quarter of 1986, then decline slightly in the first half of 1987. On top of this trend, MBA expects interest rates to continue to be volatile as nervous credit markets react to exchange rate adjustments and indicators of a modest rebound of economic growth during this fourth quarter. The yield on 10-year Treasury notes, currently around 7¼ percent, should decline to 7 percent in the first half of 1987, while contract mortgage interest rates should fall to the 9 to 9½ percent range.

The single-family housing sector should remain strong in 1987, though not as strong as in recent months. Now that mortgage interest rates have remained at relatively low levels for an appreciable period of time, any increase in the level of demand for housing must arise largely from increases in income or in household formation. Thus, the anticipated sluggish economic growth should result in single-family starts in the 1.2 to 1.3 million unit range. However, continued strength in existing home sales and a still significant amount of refinancing volume should result in total single-family origination volume in excess of $325 billion. Commercial construction and multifamily starts will probably fall well below 1986 levels, due to the effects of the new tax bill and continued high vacancy rates in key markets.

Dr. Victor Cholewicki
Economist
October 15, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
MAR	151	104	47	1,960	1,305	655	152	99	53	1,834	1,150	684
APR	188	126	62	2,019	1,321	698	180	125	55	1,885	1,256	629
MAY	187	134	53	1,853	1,324	529	170	120	50	1,788	1,210	578
JUN	184	131	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	176	124	52	1,815	1,236	579	165	115	50	1,759	1,196	563
AUG$_P$	**166**	**118**	**48**	**1,822**	**1,288**	**534**	**143**	**99**	**44**	**1,654**	**1,137**	**517**
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
8 MONTHS												
1986	1,274	888	386				1,213	821	392			
1985	1,176	805	371				1,161	744	417			
1984	1,224	844	380				1,184	778	406			
1983	1,144	809	335				1,079	636	443			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
MAR	21	21	69	40	332	344	763	521	21	20	64	46	276	287	718	553
APR	29	32	75	51	324	365	796	534	29	33	69	49	302	333	727	523
MAY	28	28	78	53	266	251	813	523	29	31	62	49	277	301	687	523
JUN	30	35	70	48	283	300	768	501	28	30	66	50	274	286	728	504
JUL	29	36	64	46	283	352	706	483	30	31	61	43	314	297	692	457
AUG$_P$	**35**	**31**	**60**	**41**	**333**	**296**	**708**	**485**	**25**	**27**	**52**	**39**	**271**	**284**	**644**	**455**
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
8 MONTHS																
1986	199	204	530	341					189	194	487	343				
1985	158	159	535	324					171	156	509	325				
1984	127	164	623	310					129	144	581	330				
1983	114	143	629	259					107	122	590	261				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
MAR	277	89	331	4.5	221.1	95.7	30.8	94.6	1,099	627	472	133	92	41
APR	336	84	334	4.5	224.2	97.5	31.9	94.8	1,135	638	497	129	94	35
MAY	330	75	335	5.3	224.3	99.5	32.9	91.9	1,132	648	484	148	94	54
JUN	338	66	342	5.8	226.7	102.4	32.8	91.5	1,153	665	488	150	103	47
JUL	335	57	353	6.2	229.6	104.8	32.5	92.3	1,160	679	481	151	101	50
AUG$_P$	348	49	357	7.3	232.6	106.5	32.2	93.9	1,167	686	481	159	107	52
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
8 MONTHS														
1986	2,396	535										1,089	736	353
1985	2,143	484										1,110	750	360
1984	2,028	451										1,064	730	334
1983	1,880	430										841	610	231

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
NOV	$32,864	$5,660	$12,363	$11,886	$2,955	$21,142	$5,200	$9,357	$6,491	$94
DEC	43,586	5,730	15,919	16,189	5,748	22,814	5,158	10,101	7,162	393
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR$_P$	42,416	8,699	15,811	15,490	2,416	30,533	8,188	12,705	9,375	315
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
4 MONTHS										
1986	130,215	28,928	49,991	43,154	8,142	92,687	26,816	39,103	25,879	889
1985	93,121	17,641	38,764	30,431	6,285	61,068	16,221	28,405	16,193	249
1984	86,439	19,458	36,958	25,845	4,178	60,200	18,284	27,484	14,190	242
1983	72,554	19,608	25,360	24,004	3,582	53,474	18,430	19,736	15,100	208

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
NOV	$2,545	$163	$1,401	$716	$245	$9,137	$277	$1,605	$4,639	$2,616
DEC	5,048	274	2,935	1,111	728	15,724	298	2,883	7,916	4,627
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR$_P$	2,394	320	1,305	416	353	9,439	191	1,801	5,699	1,748
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
4 MONTHS										
1986	8,733	1,029	4,900	1,835	969	28,795	1,083	5,988	15,440	6,284
1985	7,028	758	3,999	1,714	557	25,025	662	6,360	12,524	5,479
1984	6,132	156	3,829	1,690	457	20,107	1,018	5,645	9,965	3,479
1983	4,150	306	2,245	1,339	260	14,930	872	3,379	7,565	3,114

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
NOV	$29,343	$6,636	$13,967	$5,476	$3,264	$112,662	$12,237	$49,249	$32,014	$19,162
DEC	28,511	6,489	14,889	4,693	2,440	109,632	14,091	47,704	31,459	16,378
1986										
JAN	26,031	7,695	12,913	3,000	2,423	96,650	13,930	47,353	18,327	17,040
FEB	31,132	7,954	13,907	6,680	2,591	108,898	16,153	44,355	30,732	17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR$_P$	44,395	9,813	21,823	8,751	4,008	130,476	20,753	53,917	35,033	20,773
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
4 MONTHS										
1986	144,553	40,128	66,430	24,549	13,446					
1985	81,328	14,018	48,881	8,803	9,626					
1984	87,753	16,850	47,037	15,365	8,501					
1983	64,284	15,991	32,847	10,284	5,162					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
MAR	305	211	33	61	115	$7,752	57	$3,477	23	$1,621	35	$2,654
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,878	64	3,971	27	1,942	62	4,965
AUG$_P$	265	128	44	93	203	13,908	107	6,551	37	2,657	59	4,700
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
8 MONTHS												
1986	2,343	1,427	287	629	1,062	73,525	494	30,508	198	14,204	370	28,813
1985	1,447	578	147	722	794	51,623	192	10,791	113	7,568	489	33,264
1984	1,279	285	135	859	972	62,643	155	8,273	149	9,579	668	44,791
1983	1,344	593	206	545	789	46,938	250	12,534	173	10,893	366	23,511

SECONDARY MARKET ACTIVITY

(Dollars in millions)

	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
YEAR AND MONTH	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1986										
MAR	$1,917	$1,410	$62,310	$2,260	$7,213	$7,128	$5,318	$5,900	$14,853	$5,059
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAY	3,538	1,978	67,312	4,491	9,857	10,612	8,947	8,162	4,863	5,872
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL	3,270	3,343	76,197	6,106	n.a.	n.a.	n.a.	n.a.	14,246	10,226
AUG^P	3,840	3,800	81,060	7,079	n.a.	n.a.	n.a.	n.a.	10,177	6,813
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
8 MONTHS										
1986	23,282	17,510	—	36,545	45,419	49,296	39,279	37,576	83,022	53,351
1985	13,798	14,718	—	11,933	22,120	24,353	18,574	17,018	39,097	25,900
1984	13,320	11,231	—	8,811	10,564	11,108	8,271	7,308	24,461	19,962
1983	11,518	11,559	—	10,090	11,601	12,130	11,687	11,043	51,394	36,087

* FHLMC Year-to-date totals are for six months only.

INTEREST RATES AND YIELDS

	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA	CONVENTIONAL		CONVENTIONAL				
YEAR AND MONTH	New[4]	New	Existing	New	Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	APT's
1986								
APR	9.80%	9.99%	9.99%	10.27%	10.37%	8.49%	9.300%	10.84%
MAY	10.07	10.32	10.33	10.22	10.15	8.70	9.663	10.81
JUN	9.98	10.38	10.39	10.15	10.20	8.60	10.050	11.62
JUL	10.01	10.28	10.32	10.30	10.26	8.29	9.813	12.02
AUG	9.80	9.88	9.92	10.26	10.26	7.96	9.455	11.45
SEP$_P$	n.a.	n.a.	n.a.	10.22	10.08	7.86	9.588	12.16

	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
					U.S. Government		
YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	10-yr.	26-wk.	Prime Comm. Paper 90-119 Days
1986							
APR	9.01%	9.08%	9.12%	9.26%	7.30%	6.08%	6.60%
MAY	9.33	n.a.	n.a.	9.50	7.71	6.19	6.62
JUN	9.57	9.71	9.75	9.65	7.80	6.27	6.71
JUL	9.32	9.48	9.49	9.57	7.30	5.86	6.33
AUG	9.11	9.21	9.24	9.51	7.17	5.55	5.92
SEP	9.28	9.27	9.32	9.56	7.45	5.35	5.71

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
APR	54	171	178	182
MAY	57	162	n.a.	n.a.
JUN	41	177	191	195
JUL	50	202	218	219
AUG	29	194	204	207
SEP	n.a.	183	182	187

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**	**4,880**	**3,860**	**70**	**770**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

		1-4 Units				5+ Units			
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts

[3] Series labeled non-residential are also inclusive of farm data

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100

[5] Year to date seasonally adjusted series not calculated

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MORTGAGE BANKING

VOLUME 47 NO. 3
DECEMBER 1986

ARTICLES

PAGE 10
INVASION OF THE MORTGAGE SNATCHERS
Stuart A. Feldstein
This article traces the development of today's new competitive environment, describing the non-traditional players who are rapidly entering the world of real estate finance. New strategies will be needed as these big players change the way production marketing is conducted.

PAGE 20
DIRECT CONSUMER CONTACT: SENDING OUT THE RIGHT SIGNALS
Warren J. Dunn and
J. Michael McFall
A simple advertising drive can become an effective marketing campaign when lenders become involved in planning, guiding and evaluating their campaigns. A series of activities that represent the most common and useful components for setting up a direct consumer contact program is presented.

PAGE 34
SERVING THE CUSTOMER FROM TOP TO BOTTOM
James C. Pratt and
James L. Hennessy, Jr.
Everyone in an organization is a salesperson. Everyone has somebody to please either internally or externally. So the need for effective customer service by the mortgage banker has never been greater. These authors suggest ways in which lenders can improve their customer service.

PAGE 44
FIFTY WAYS TO PLEASE YOUR MARKET
Although there is a growing awareness and recognition of the value of direct consumer contact by the industry, many are asking whether or not such programs are cost-effective. In this Round Table, eight industry experts discuss their views and ways to set up a successful program.

PAGE 61
ATTENTION ALL HOME SHOPPERS
K-Mart/Margaretten Special
Alan Dailey
K-Mart and Margaretten have a consumer-oriented pre-qualification service that shoppers can use while shopping at K-Mart to determine exactly how large a mortgage for which they may qualify. Then the consumer can go to the lender knowing within what price range he has to shop. This is one of many new forms of financial services in which mortgage bankers are becoming engaged.

PAGE 66
OUTDO YOUR COMPETITION: CUSTOMIZED PACKAGED SERVICES
J. Michael McFall
Because the Realtor's role in the origination process is continually becoming more important, lenders must identify their individual strengths and assess their competition so they will be able to promote their unique qualities to Realtors and consumers.

PAGE 79
THE FUTURE OF MORTGAGE BANKING: A WINDOW ON THE WORLD
Warren Lasko
MBA's executive vice president identifies 12 market factors that will shape the future of mortgage banking. The real estate finance industry is undergoing and will continue to undergo a frenetic pace of change and innovation. Automation and deregulation has changed the financial world.

PAGE 87
TAX REFORM: A SEA CHANGE
Steven A. Wechsler
This article provides an analysis of the Tax Reform Act of 1986 and describes its effects on commercial real estate.

PAGE 97
TAX REFORM'S ATTACK ON RENTAL HOUSING
Lawrence B. Simons and
Anthony S. Freedman
This article reviews the provisions of the tax bill that directly affect rental housing. These authors believe the end result will be a vastly changed environment for the ownership and development of rental housing.

PAGE 105
BUSINESS BASICS—SOLVING THE TURNOVER BLUES
George Bailey and
Thomas O. Davenport
There are practical ways of reducing turnover and companies can use the checklist provided in this article to evaluate their own approaches to the problem.

PAGE 109
THE LAST WORD (TACKLING A MEDIA BLITZ)
Bill Patterson
Some guidelines for dealing with the media are outlined in this article. Knowing what to do can enable you to face any situation calmly.

DEPARTMENTS

ABOUT THE ISSUE 5
LETTERS 8
BUSINESS BASICS 105
PEOPLE 112
SECONDARY MORTGAGE MARKETS 123
MORTGAGE MARKET TRENDS 125
AD INDEX 134

J. Michael McFall

OUTDO
YOUR COMPETITION
Customized Packaged Service

One key to ensuring successful loan originations is the lender's ability to provide superior service to real estate agents. Even during the recent crunch of refinancing business, most lenders took steps to protect longstanding relationships by emphasizing service to real estate agents.

In retrospect, this strategy was probably a smart one. Real estate agents represent an important link with customers, and according to surveys, can influence up to one-half of all loan originations nationwide.[1]

There is increasing evidence that the Realtor's role is becoming more significant as a middleman in the loan origination process. As Realtors help consumers understand the growing complexities of loan instruments, they are assisting in the search for mortgage financing. The Realtor's function becomes increasingly important as customers begin to shop frequently for financing. And while some speculate that the Realtor's role might diminish in light of innovations such as computer loan originations systems (CLOs), there is no evidence to suggest that this is the case.

Given the importance of the real estate agent, it seems appropriate to examine the attitudes, actions and alliances that are common among members of this group. While this exercise may serve only to confirm some commonly held assumptions, it can be useful in prioritizing consumer needs and developing a strategy for increasing originations.

Most lenders assume that factors such as loan rate, speed of processing and lender reputation affect the real estate agents' inclination to recommend one lender over another. It is valuable to know whether or not these impressions are correct and to what extent various qualities in lenders affect the real estate agent's decision.

It also seems evident that salesmanship may be a factor in real estate agent referrals. Loan officers and others may benefit by knowing more about how a loan officer's friendliness, salesmanship and reputation affect the real estate agent's inclination to make a referral.

In addition, it seems important to know more about the real estate agent's involvement in the lending process. By knowing more about the services that are performed by agents before the loan application is taken, lenders can better provide information and assistance to customers.

This information can then be translated into an action plan for loan originators. Lenders who recognize and capitalize on the unique needs of the real estate agents can better position themselves for increased single-family loan originations.

MBA survey

To acquire this information, the Mortgage Bankers Association (MBA) conducted a written survey among 426 active Realtors.[2] The survey asked a variety of questions about services performed, referral practices and qualities sought in a lender. While there are limitations to any type of market research, it is possible to make significant inferences about Realtor behavior that may be useful.

It is important to note that the survey was conducted during the summer of 1986, a time when origination volume was high and loan processing was low. Although this may have been a factor in the results, the survey paints a clearer picture of Realtor preferences.

Based on the survey responses, Realtors are very involved in many aspects of the financing process. While fewer than 11 percent of the Realtors surveyed actually take a loan application, almost all indicated that they discuss with homebuyers such topics as down payments and the costs associated with loan closing. Approximately the same number, 90 percent, help buyers prequalify for a loan. It seems logical that Realtors are interested in performing prequalification tasks that lead to an evaluation of buyer affordability. As a result, most lenders work with Realtors on buyer qualification techniques.

Referral practices

A large number of the Realtors surveyed are involved in helping homebuyers find a lender. Nearly 90 percent make a recommendation for one or more sources of financing. Most Realtors recommend a minimum of two lenders, few recommend more than four. The average number of lenders recommended by Realtors is three.

When they make a recommendation, most Realtors are confident that it will be followed. In MBA's survey, 81 percent of the Realtors felt that their recommendations were always followed by the homebuyer. It seems evident that if the Realtors' estimates are true, lenders must continue to

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work with Realtors in order to be included on their referral list.

Realtor recommendations seem to have an influence on the number of loan applications that go to banks, thrifts and mortgage bankers. At the time MBA's survey was conducted, mortgage bankers held a 28 percent share of single-family loan origination market. Savings and loans held a 42 percent share of the market, while banks held a 20 percent share.[3]

To test the influence of Realtors, MBA asked survey participants to report how often they recommended banks, thrifts and mortgage bankers. In the survey, the Realtors' response for banks was identical to the actual market share. The percentage of business recommended to thrifts was 31 percent, somewhat below the actual market share and for mortgage bankers it was 36 percent, somewhat greater than the actual market share. This may reflect a slight survey bias in favor of mortgage bankers but generally supports the MBA hypothesis that Realtor recommendations are influential in determining overall origination volumes among lenders.

While almost all Realtors are eager to recommend lenders and to qualify buyers, the survey revealed that 59 percent will go as far as to recommend a particular loan type. According to the survey, when Realtors are inclined to suggest a loan type, they are most likely to be working with new homebuyers and most often recommend Federal Housing Administration (FHA) or Veterans Administration (VA) loans. This is especially important for mortgage bankers who originate a high proportion of these loans. It may also represent an opportunity to provide service that is unavailable from other types of lenders.

Approximately 60 percent of the Realtors in the MBA survey help homebuyers understand mortgage and title insurance and only a very few, 21 percent, provide brochures on home financing. And, as mentioned earlier, 11 percent actually take an application. Of the 11 percent, only one-half were affiliated with computerized loan origination systems, suggesting that CLOs have made a minimum impact on the loan origination process.

J. Michael McFall is senior director of marketing and publications at MBA. His marketing and association experience include positions with the Music Educators National Conference and a prominent Baltimore advertising agency.

> *"We speculate that despite the recent controversy about Realtors serving as loan originators, most prefer to concentrate on selling homes, relying on lenders for the financing."*

We speculate that despite the recent controversy about Realtors serving as loan originators, most prefer to concentrate on selling homes, relying on lenders for the financing. The few Realtors who actually take an application are most often affiliated with a large office, suggesting that the larger chain real estate brokerage companies may be the ones most concerned about becoming loan originators.

This is an area that merits continued observation. If major retailers and securities brokers continue their presence in the real estate brokerage market, loan officers may soon confront a situation where many Realtors have become captive and growth is limited. On the other hand, the divestiture of the Merrill Lynch real estate brokerage operation may signal an end to the threat of captive real estate agents. This situation varies widely by market.

Report card on lenders

MBA also asked Realtors to provide a report card on the qualities they seek in lenders. In this report card, they were asked to evaluate qualities such as loan rate or lender reputation on a scale from one (low) to five (high). The average scores for each of the 14 attributes are reported in Table 1 and are listed according to the average level of importance.

Realtors reported a high average score for speed of processing, loan officer responsiveness and lender reputation. To some extent, the emphasis on speed and responsiveness may be a reflection of the time during which the survey was conducted. Based on the strength of these scores, however, it is unlikely that these qualities would move out of the top three if the survey were repeated at another time.

Average scores, while illustrative, do not clearly identify patterns among lender attributes and the manner in which they are related to one another. We would suspect that some of the attributes might be similar in influence and that it might be possible to look for an intercorrelation among the variables. This intercorrelation can be used to form groups of similar attributes, which can then be used in a discussion of sales strategy. Consequently, MBA employed a statistical technique known as factor analysis in order to better group and classify Realtor preferences.[4]

The factor analysis identified four clusters or groups of attributes. Within each group, there is a high amount of similarity in scores and, therefore, the attributes within the group form a strategic package.

For discussion purposes, each group has been assigned labels. The first group deals with loan officer personality and salesmanship. The second group deals with lender convenience, while the third group concerns lender affiliations. The fourth group refers to loan characteristics. The groupings are shown in Table 2.[5]

Salesmanship

The first factor group, which has been labeled salesmanship, includes responsiveness, friendliness, eagerness to qualify borrowers, salesmanship, ability to explain loan types and

TABLE 1

Realtor Qualities AVERAGE SCORE (1=Low, 5=High)

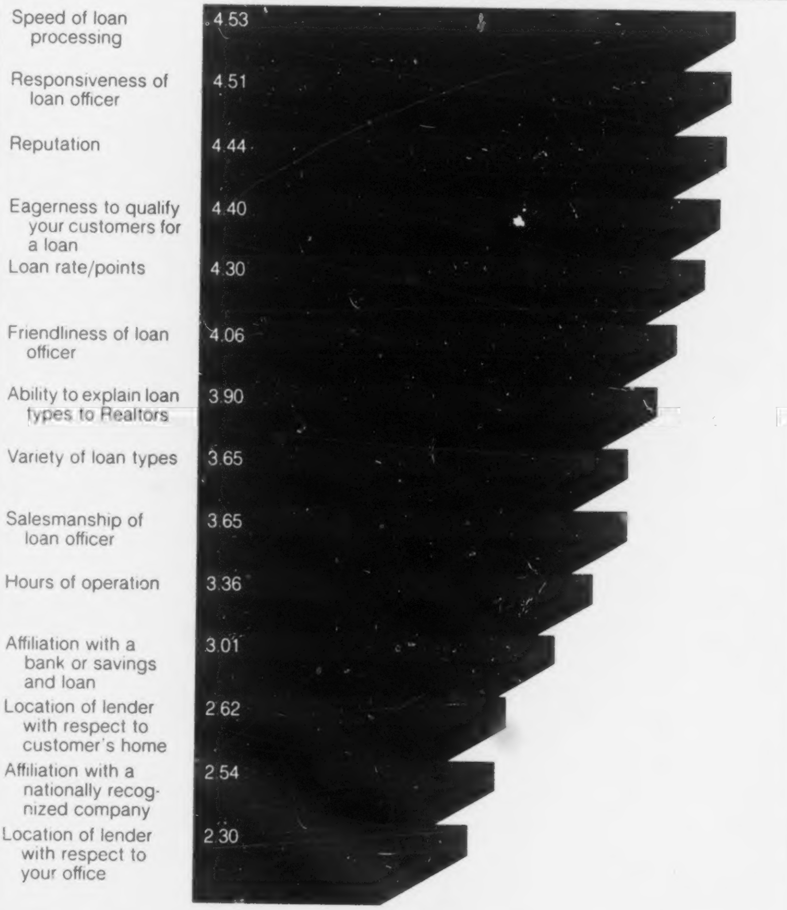

TABLE 2

Pearson Correlation Matrix

Salesmanship	Responsiveness	Friendliness	Eagerness to Quality	Salesmanship	Ability to Explain Loans	Reputation
Responsiveness	1.000					
Friendliness	0.551	1.000				
Eagerness to Qualify	0.473	0.383	1.000			
Salesmanship	0.333	0.454	0.331	1.000		
Ability to Explain Loans	0.337	0.322	0.390	0.349	1.000	
Reputation	0.327	0.322	0.412	0.384	0.319	1.000
Location	Location to Realtor	Location to Customer	Convenience			
Location to Realtor	1.000					
Location to Customer	0.537	1.000				
Convenience	0.371	0.237	1.000			
Affiliation	Local Affiliation	National Affiliation				
Local Affiliation	1.000					
National Affiliation	0.520	1.00				
Loan Characteristics	Rate	Speed	Variety			
Rate	1.000					
Speed	0.486	1.000				
Variety	0.282	0.224	1.000			

reputation. The data suggest that Realtors are very receptive to "the personal touch" when dealing with lenders. They are interested in working with lenders who spend the time to cultivate a relationship, not just drop off a rate sheet. In addition, the job of salesmanship does not end with taking the loan application. Loan officers must continue to communicate on the status of the loan package. One Realtor expressed concern for what he called the surprise ending.

> "I hate to come up on closing only to find that a critical document is missing. When I recommend a lender, I look for lenders who can track the status and report on progress."

Another Realtor commented that while he may sometimes recommend a lender, he is "much more inclined to recommend a specific loan officer rather than a specific lender. The high turnover among loan officers is a problem . . . when there is a personnel change, the loan package is often delayed."

There may be an advantage for lenders to use loan processing systems that can report on the progress of applications. Processing systems that have built-in checkpoints and report missing documentation problems are useful in building Realtor confidence. In addition, loan officers who are in touch with the processing staff and communicate regularly with the Realtor have a significant advantage.

It is interesting to note that overall lender reputation is highly related to the items in the salesmanship grouping. This suggests that salesmanship may be more significant in determining corporate reputation, than having a variety of loan types or the best rate. In fact, salesmanship and service may be determining factors.

While this might contradict the commonly held wisdom that rates are most significant, it is important to remember that in many markets, a rate parity situation exists. Considering rate alone, most lenders appear very similar offering the same rates. Therefore, other qualities such as service might tend to separate lenders.

It is also possible that by making several referrals, the Realtor is delegating the actual rate shopping task to the customer. Therefore, from the

Realtor's point of view, lenders with higher salesmanship qualities may be the most preferable.

The importance of the salesmanship category may be of strategic value to some lenders. Given that most lenders appear similar to Realtors, it is important to cultivate a uniqueness in order to achieve a competitive advantage.

This uniqueness may be achieved through offering ongoing training programs in salesmanship, purchasing a processing system that provides feedback, supplying brochures on loan types and conducting Realtor seminars.

Convenience

The next factor group deals with convenience. It includes the location of the lender's office compared to the customer and Realtor and hours of operation.

The location factor is directly influenced by the number of lender branches and their placement.

It seems that Realtor preferences agree with a recent survey taken among consumers. In 1985, MBA discovered that convenience was highly significant in the consumer's choice of a lender. Convenience was the most important factor for 35 percent of the surveyed customers. Rate was significant for 34 percent while company reputation was most important for 22 percent.[6]

When compared to convenience, rate appears to be a less significant factor in the customer's decision to choose a lender. Despite this, most consumers (71 percent) in the MBA study indicated that they had received the best interest rate. Clearly one-half of these had actually shopped for a mortgage.

The convenience factor may be of strategic benefit to lenders whose branch locations dominate a market or where loan officers regularly travel in order to accept applications. Rather than concentrating on promoting other attributes, these lenders might successfully take advantage of their unique strength to position themselves among Realtors and customers.

This strategy would be most effective as a countermeasure aimed at competitors who stress rate. It may also be beneficial in reducing dependence on rate as a method for attracting customers. Market conditions may make it impossible to always be a rate leader. Therefore, a strategy based on convenience may be an ideal alternative.

> *"There is increasing evidence that the Realtor's role is becoming more significant as a middleman in the loan origination process."*

Affiliations

Corporate affiliation is the subject of the third factor grouping. Although mortgage lending has always been a regional business, changes in banking regulations and new entrants have brought many recognizable corporate names into the competitive arena. MBA believes that these might be influential in the Realtor's recommendation of a lender.

There is no conclusive evidence to suggest affiliation has a significant influence on Realtors, although a recent study by ERA Associates has revealed that 73 percent of the Realtors reported that their customers would be inclined to choose an out-of-town lender if that lender offered loans that were 1 percent below the market.[7] The ERA Associates study, while not conclusive, may indicate that loan rate can be used by major recognizable companies to gain an advantage.

From a strategic perspective, lenders who enjoy a relationship with a recognized retailer or bank holding company may find it advantageous to promote that strength directly to consumers. (See related article page 20) The consumers' actions will be based on attitudes and opinions that are influenced by name recognition and past experience. In short, familiar names can be a strategic advantage with consumers. This will probably not be an effective strategy with Realtors whose preferences are based on actual experience with lenders. For this reason, effective direct consumer contact programs are often associated with the retail environment.

Loan characteristics

Characteristics such as speed of processing, loan rate and variety of loan types formed another grouping. It is difficult to overlook the importance of these factors. Lenders who are not delivering a competitively priced product can hardly expect to gain continued Realtor acceptance. The MBA survey suggests, however, that these qualities do not form the basis for increasing loan originations. To one degree or another, Realtors expect to find these qualities in lenders. Establishing a sales and marketing campaign on these qualities alone may be difficult.

Unique customers

Although the survey may suggest otherwise, not all Realtors are alike, nor are all consumers alike. For example, MBA thought it would be interesting to take a look at the responses of the Realtors who dealt most with mortgage bankers to determine if any significant differences exist. The hypothesis was that the Realtors who are inclined toward making referrals to mortgage bankers are unique in some way.

The survey revealed that Realtors who refer most of their customers to mortgage bankers are also working with the highest percentage of new homebuyers. The Realtors who work with mortgage bankers reported that 73 percent of their customers are first-time buyers as compared with the national average of 40 percent new homebuyers.[8] As a result, the Realtors who work with mortgage bankers

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more often recommend FHA and VA loans. Approximately 44 percent of their customers choose conventional loans. Nationwide, at the time the survey was taken, 82 percent of all loans were of the conventional type.[9]

Generally, the Realtors who refer most to mortgage bankers are also more concerned with helping their customers understand the process. Their scores on attributes such as the importance of qualifying buyers and identifying loan types are significantly higher than the total group of Realtors by as much as .5 (on the scale of one to five). They seem to be much more involved in the process and believe that their customers are much more inclined to follow their advice.

This could represent a strategic opportunity for lenders who wish to capture a higher share of FHA/VA loan originations. By positioning their company as "friendly to new homebuyers," lenders can cultivate stronger relationships with some Realtors. This can be accomplished by distributing literature on loans, and stressing simplicity in prequalifying procedures. As a result, it may be possible to establish a unique position. This is an especially attractive alternative in those markets where portfolio lenders have stricter qualifying and underwriting requirements.

Examining these surveys suggest a scenario where tasks and responsibilities are shared between the Realtor and consumer. Realtors assist in assuring customers that they will probably qualify for the loan and by providing a selection of lenders and loan types from which to choose. Customers tend to choose lenders who are convenient, are recognized for their reputation and offer loans at competitive rates.

From a strategic point of view, lenders can benefit by identifying their individual strengths, assessing the competition and then promoting their unique qualities to Realtors and consumers. □

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[1] ERA Associates, 1986 survey
[2] Questionnaires mailed to a sample of 5,000 members of the National Association of Realtors
[3] HUD survey of mortgage lending activity, first quarter, 1986
[4] Varimax rotation of a 14 x 14 Pearson correlation matrix extracting four factors
[5] Pearson correlation based on rotated value groupings
[6] *Real Estate Finance Today*, January 10, 1986
[7] ERA Associates, 1985 survey
[8] Joint Center for Housing Studies, "Homeownership and Housing Activity in the United States 1963-1984."
[9] HUD survey of mortgage lending activity, first quarter, 1986

MORTGAGE MARKET TRENDS

The pace of economic activity quickened in the third quarter after registering minimal growth in the previous period. The U.S. Department of Commerce preliminary estimates indicate that real gross national product (GNP) expanded at an annual rate of 2.4 percent during the July to September period. For the quarter, consumer spending rose at an annual rate of more than 7 percent, while business fixed investment recorded a small gain. Inventory investment and net exports both declined but the latter fell by a smaller amount than it had in the second quarter.

Despite the fact that real disposable income actually declined in the third quarter, personal consumption expenditures again rose very strongly. Consequently, the personal saving rate fell markedly in the third quarter, to 2.9 percent, its lowest level since 1950. The bulk of the increase in consumer spending reflected the surge in new automobile purchases. This in turn was a response to the cut-rate financing incentives being offered by car manufacturers. Third quarter data also show that consumer spending for goods other than automobiles was strong as well. Non-auto retail sales in this period increased 3.7 percent from the second quarter. This increase in consumer spending will be a one-time short-run stimulus for the economy, and will not carry over into 1987.

Because much of the demand in the third quarter was met from inventories, inventory investment declined sharply, particularly for automobiles. This drop in inventory investment substantially reduced the reported increase in real GNP. On the positive side, this clearing out of inventories sets the stage for higher levels of output in the fourth quarter and beyond. But, similar to the pick-up in consumer spending, the rate of increase in inventory investment will moderate as 1987 progresses.

Economic growth was also enhanced by another solid gain in residential fixed investment. Spurred by mortgage rates that have fallen below the 10 percent level, construction activity in the single-family area, in constant dollars, rose in every month this year. But, with much of the pent-up demand for construction already satisfied, the expected continuing decline in rates may mean the single-family residential market will only be able to maintain its present level of activity, which is healthy, for the rest of this year and well into 1987. Multifamily housing starts have begun to decline and are expected to continue to fall in 1987.

In addition, non-residential fixed investment also rose very slightly in the third quarter after posting declines in the previous two quarters. All of the increase came from producers' purchases of durable equipment. These expenditures may rise further in the fourth quarter because businesses will try to acquire equipment before depreciation schedules lengthen under the new tax law after December 31. However, with the capacity utilization rate remaining below 80 percent, businesses have only a limited incentive to increase expenditures on equipment. This does not bode well for future business spending. Non-residential building construction declined again, and given the high level of vacancy rates for commercial property, and the adverse effects of the pending tax changes, activity in this area will continue to fall for the next several quarters. Overall, non-residential fixed investment will probably change only marginally in 1987.

Although the trade deficit worsened in the third quarter, the decline in real net exports slackened as compared with the previous quarter. This may indicate that the slide in the value of the dollar, which during the past 18 months has depreciated by more than 30 percent against a market basket of currencies, may finally be having some stabilizing effect on net exports. This drop in the value of the dollar should enable domestic industries to compete more effectively both within the United States and abroad. Thus, the trade sector may become a source of economic stimulus in the near term. However, even if economic growth picks up in foreign markets, increasing the demand for U.S. exports, and spending patterns change in the United States, the trade deficit will remain quite substantial in 1987.

On the inflation front, the decline in energy prices has continued to hold down the rise of both producer and consumer prices, as it has most of the year. But, as the benefits of falling oil prices dissipate, and the depreciation of the dollar begins to take effect, particularly on consumer goods prices, the rate of inflation will probably return to its level of the recent past, somewhere in the 3- to 4-percent range.

The sluggishness of the economy during the first three quarters of the year, together with lower inflation and an accommodative monetary policy, has allowed interest rates to fall markedly. Currently, short-term rates are around 5¼ percent, and long-term rates, particularly the bellwether 10-year Treasury, are about 7¼ percent. Given the anticipated moderate pace of economic activity expected in the fourth quarter, interest rates should remain near their present levels for the rest of the year, and then as economic growth slows somewhat next year, interest rates will decline slightly. Specifically, mortgage rates could fall from their present level of just below 10 percent, to between 9 and 9½ percent.

Developments in the housing sector continue to be favorable. New home sales increased by over 10 percent in September to an annual rate of 690,000. Moreover, for the first nine months of the year, sales of new homes were 11 percent ahead of last year's pace. Existing home sales have increased for three straight months, and in September, they rose to a seven-year high of 3.8 million units at an annual rate. Single-family building permits also held up quite well in the third quarter, remaining at the level they had attained in the first half of the year. Both single-family home sales and construction, while not contributing much to economic growth in the short run, are likely to remain near their present pace for at least the next six months.

Mortgage Banker Association economists feel that economic growth is likely to increase somewhat further in the fourth quarter, to an annual rate of 3 to 3½ percent. A rise in production, particularly of automobiles, in order to replenish depleted inventories, and an increase in the purchase of durable goods, especially by businesses, to take advantage of present tax provisions, will be key contributing factors. However, a slowing in the growth of consumer spending, changes in the tax code, and the continuing drag from the trade sector suggest that the growth of real GNP will slow to an annual rate of 2 to 2½ percent during the first half of 1987.

Robert Rosenblatt *November 14, 1986*

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS Actual Total	HOUSING STARTS Actual 1-4 Units	HOUSING STARTS Actual 5+ Units	HOUSING STARTS Seasonally Adjusted Annual Rates Total	HOUSING STARTS Seasonally Adjusted Annual Rates 1-4 Units	HOUSING STARTS Seasonally Adjusted Annual Rates 5+ Units	PERMITS 17,000 ISSUING PLACES Actual Total	PERMITS 17,000 ISSUING PLACES Actual 1-4 Units	PERMITS 17,000 ISSUING PLACES Actual 5+ Units	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates Total	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates 1-4 Units	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates 5+ Units
1986												
APR	188	126	62	2,019	1,321	698	180	125	55	1,885	1,256	629
MAY	187	134	53	1,853	1,324	529	170	120	50	1,788	1,210	578
JUN	184	131	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	166	118	48	1,818	1,287	531	144	100	44	1,673	1,147	526
SEP$_p$	155	109	46	1,680	1,178	502	153	104	49	1,613	1,153	460
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
9 MONTHS												
1986	1,426	995	431				1,369	926	443			
1985	1,324	903	421				1,330	837	493			
1984	1,372	943	429				1,315	844	471			
1983	1,299	917	382				1,229	800	429			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS Actual North East	STARTS Actual Mid-West	STARTS Actual South	STARTS Actual West	STARTS Seasonally Adjusted Annual Rates North East	STARTS Seasonally Adjusted Annual Rates Mid-West	STARTS Seasonally Adjusted Annual Rates South	STARTS Seasonally Adjusted Annual Rates West	PERMITS 17,000 ISSUING PLACES Actual North East	PERMITS 17,000 ISSUING PLACES Actual Mid-West	PERMITS 17,000 ISSUING PLACES Actual South	PERMITS 17,000 ISSUING PLACES Actual West	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates North East	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates Mid-West	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates South	PERMITS 17,000 ISSUING PLACES Seasonally Adjusted Annual Rates West
1986																
APR	29	32	75	51	324	365	796	534	29	33	69	49	302	333	727	523
MAY	28	28	78	53	266	251	813	523	29	31	62	49	277	301	687	523
JUN	30	35	70	48	283	300	768	501	28	30	66	50	274	286	728	504
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	692	457
AUG	35	31	60	40	333	302	706	477	25	28	52	39	272	289	653	459
SEP$_p$	28	27	60	39	282	269	696	433	31	28	53	41	302	258	598	455
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
9 MONTHS																
1986	227	231	590	379					220	223	541	384				
1985	182	182	596	364					195	180	574	381				
1984	146	187	692	347					148	162	642	364				
1983	128	167	712	293					125	143	664	298				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
APR	336	84	336	4.5	224.2	97.5	31.9	94.8	1,135	638	497	129	94	35
MAY	330	75	336	5.3	224.3	99.5	32.9	91.9	1,132	648	484	148	94	54
JUN	338	66	340	5.8	226.7	102.4	32.8	91.5	1,153	665	488	150	103	47
JUL	336	57	349	6.2	229.5	104.4	32.6	92.5	1,157	675	482	151	101	50
AUG	341	52	354	6.8	232.7	105.8	32.4	94.5	1,164	682	482	160	109	51
SEP$_p$	317	56	357	6.3	235.4	107.5	32.6	95.3	1,155	678	477	168	111	[illegible]
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
9 MONTHS														
1986	2,706	538										1,267	863	404
1985	2,448	595										1,247	846	401
1984	2,244	504										1,210	834	376
1983	2,120	478										974	709	265

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
DEC	$43,586	$5,730	$15,919	$16,189	$5,748	$22,814	$5,158	$10,101	$7,162	$393
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY$_p$	47,933	11,263	18,630	15,326	2,714	36,074	10,597	15,793	9,400	254
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
5 MONTHS										
1986	179,487	41,529	68,621	58,481	10,856	130,016	38,668	54,896	35,509	1,143
1985	121,787	22,541	51,964	38,948	8,334	81,021	20,950	38,673	21,089	309
1984	119,594	24,622	50,351	39,052	5,569	83,330	23,048	37,938	21,993	351
1983	94,690	25,221	33,708	31,360	4,401	69,617	23,642	26,639	19,071	265

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[3]	S&Ls	Banks[2]	Life Cos.
1985										
DEC	$5,048	$274	$2,935	$1,111	$728	$15,724	$298	$2,883	$7,916	$4,627
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAYp	2,541	480	1,363	471	218	9,318	177	1,474	5,425	2,242
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
5 MONTHS										
1986	11,358	1,602	6,263	2,306	1,187	38,113	1,259	7,462	20,866	8,526
1985	9,019	792	5,237	2,218	772	31,747	799	8,054	15,641	7,253
1984	8,371	339	5,084	2,379	569	27,893	1,235	7,329	14,680	4,649
1983	5,296	355	2,794	1,829	318	19,777	1,224	4,275	10,460	3,818

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
DEC	$28,511	$6,489	$14,889	$4,693	$2,440	$109,632	$14,091	$47,704	$31,459	$16,378
1986										
JAN	26,031	7,695	12,913	3,000	2,423	96,650	13,930	47,353	18,327	17,040
FEB	31,132	7,954	13,907	6,680	2,591	108,898	16,153	44,355	30,732	17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAYp	[illegible]	9,844	23,380	26,109	5,365	150,243	[illegible]	56,400	38,439	23,175
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
5 MONTHS										
1986	212,152	52,874	89,810	50,657	18,811					
1985	117,479	18,525	63,981	22,918	12,055					
1984	115,814	22,569	63,034	20,779	9,432					
1983	94,515	30,464	43,469	14,115	6,467					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1986												
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,878	64	3,971	27	1,942	62	4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEPp	274	141	51	82	151	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	61	[illegible]
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
9 MONTHS												
1986	2,617	1,568	338	711	1,241	85,909	564	34,602	246	17,671	431	33,636
1985	1,648	660	173	815	923	60,178	239	13,562	132	8,896	552	37,720
1984	1,411	318	146	947	1,072	69,177	169	9,006	161	10,345	742	49,826
1983	1,503	639	232	632	950	56,639	306	15,455	206	12,985	438	28,199

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAY	3,538	1,978	67,312	4,491	9,857	10,612	8,947	8,162	4,863	5,872
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL	3,270	3,343	76,197	6,106	8,585	7,863	8,518	8,118	14,246	10,226
AUG	3,840	3,800	81,060	7,079	n.a.	n.a.	n.a.	n.a.	10,177	6,813
SEPp	4,046	4,688	85,388	7,257	n.a.	n.a.	n.a.	n.a.	20,333	12,601
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
9 MONTHS										
1986	27,530	22,158	—	43,902	54,004	57,159	47,797	45,694	119,356	66,213
1985	15,435	16,457	—	15,587	24,834	27,611	23,200	21,403	46,024	30,302
1984	14,461	12,376	—	9,903	15,650	15,036	9,559	8,887	27,527	21,882
1983	14,317	12,762	—	11,108	16,222	16,801	13,210	12,534	58,142	40,288

* FHLMC Year-to-date totals are for seven months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5] APT's
1986								
MAY	10.07%	10.32%	10.33%	10.22%	10.15%	8.70%	9.663%	10.81%
JUN	9.98	10.38	10.39	10.15	10.20	8.60	10.050	11.62
JUL	10.01	10.28	10.32	10.30	10.26	8.29	9.813	12.02
AUG	9.80	9.88	9.92	10.26	10.26	7.96	9.455	11.45
SEP	9.90	9.96	9.95	10.17	10.08	7.86	9.588	12.16
OCTp	n.a.	n.a.	n.a.	10.03	9.97	7.75	9.425	12.09

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
MAY	9.33%	n.a.	n.a.	9.50%	7.71%	6.19%	6.62%
JUN	9.57	9.71	9.75	9.65	7.80	6.27	6.71
JUL	9.32	9.48	9.49	9.57	7.30	5.86	6.33
AUG	9.11	9.21	9.24	9.51	7.17	5.55	5.92
SEP	9.28	9.27	9.32	9.56	7.45	5.35	5.68
OCT	9.05	9.14	9.18	9.48	7.43	5.26	5.66

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
MAY	57	162	n.a.	n.a.
JUN	41	177	191	195
JUL	50	202	218	219
AUG	29	194	204	207
SEP	34	183	182	187
OCT	n.a.	162	171	175

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING

JANUARY 1987

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MORTGAGE BANKING

VOLUME 47 NO. 4
JANUARY 1987

ARTICLES

PAGE 8
LOAN PRODUCTION: RECOGNIZING THE MOST VALUABLE PLAYERS
Sidney Lenz
In loan production, the employees play a major role in the success or failure of a company. This article explores ways to balance quality and quantity by offering the right incentives to employees. The right benefits, compensation and office equipment seem to be the key.

PAGE 19
QUALITY CONTROL SYSTEM: "ZERO DEFECT"
Carolyn Williams Trim
This article offers an evaluation of your company's inhouse quality control system. The author poses all the questions management should be asking. More mortgage bankers are adopting the "zero defect" philosophy even at the expense of short-term profitability.

PAGE 28
QUALITY LOAN PRODUCTION WITH "BUDDY" REVIEW
Dave Hershman
Each loan originator and loan processor has their work reviewed by a peer to improve the quality of loans. The branch manager or production manager cannot review every loan application sufficiently enough and still have enough time to run a production branch. The "buddy" system offers a means to function more efficiently.

PAGE 41
FEDERAL INSURERS: ON TRACK WITH LENDER PERFORMANCE
Brian Chappelle
This article outlines what FHA and VA are doing to improve the quality of their loans. Both agencies are currently trying to develop comprehensive and objective criteria for evaluating and monitoring lender performance. MBA believes that using this additional data to evaluate lender performance can only have a positive impact on mortgage bankers who originate quality loans.

PAGE 47
BRANCH MANAGEMENT: BALANCING QUALITY WITH QUANTITY
Jill M. Meents
This article addresses what branch managers need to do to stay on top of quality loan production during times of high volume. Branch management must be committed to monitoring employees' comprehension of and compliance to company policies.

PAGE 53
HUD: THE WHITE GLOVE INSPECTOR
Phillip L. Shulman
This article describes the compliance techniques presently available to HUD and its current enforcement measures. Several suggestions for internal controls for mortgage bankers are provided to prevent them from incurring administrative sanctions.

PAGE 67
UNDERSTANDING CMO RESIDUALS
Thomas A. Kasper and Les Parker
An analysis of residual cash flows is presented in this article. What are residuals and what is the difference between an "owner's trust" CMO residual and residuals under REMIC? These questions are answered.

PAGE 74
TAX REFORM: SHRINKING HOMEOWNERSHIP
Linda Knell Bumbalo
The full deductibility of mortgage interest has become a casualty of tax reform. Tax rates are down, the standard deductions and personal exemptions are up and itemized deductions are gone. All of these changes will have an effect on homeowners.

PAGE 78
A TRADITIONAL THRIFT DISCOVERS 20TH CENTURY AUTOMATION
LeRoy C. Marten
This case study examines what it takes to automate a large mortgage banking operation. A committed partnership and planning are the key elements to installing a large networked system.

PAGE 91
PROTECTION FOR LENDERS AND BORROWERS; JOB-LOSS MORTGAGE INSURANCE
Richard T. Harris
Job-loss insurance protection is a form of mortgage insurance that will pay the borrower's full mortgage payment for a specified time while the borrower gets a new job. Unemployment need not cost someone their home.

PAGE 97
BUSINESS BASICS HOW TO GET THE QC BALL ROLLING
John M. Hannon
Nine steps are outlined for setting up a quality control system that proved successful for a commercial bank.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 97
PEOPLE 112
BOOKS 113
SECONDARY MORTGAGE MARKETS 115
MORTGAGE MARKET TRENDS 117
AD INDEX 126

UNDERSTANDING
CMO RESIDUALS

Thomas A. Kasper and Les Parker

Since first introduced by the Federal Home Loan Mortgage Corporation (Freddie Mac) in June 1983, collateralized mortgage obligations (CMOs) have created the most efficient security structure to date for distributing mortgage cash flow to investors. Since the first issue over three years ago, more than $60 billion of CMOs have been issued by a variety of institutions. Besides Freddie Mac, investment bankers, homebuilders, thrifts, mortgage bankers, insurance companies and real estate investment trusts (REITs) have issued CMOs for a variety of reasons (See Chart 1). CMOs account for approximately 75 percent of all AAA-rated corporate debt issued since mid-1983.

The CMO is an extension of ongoing efforts dedicated to securitizing mortgage cash flow. The cash flow from a collateral pool of mortgage securities or mortgages is the credit support for principal and interest on the bonds. However, the cash flow is allocated to different maturities sequentially. Typically, the last class or "Z-bond" of a CMO issue receives no cash distributions until all earlier classes (generally receiving interest currently) are paid. During this time, the balance of the Z-bond "accretes" or compounds at its coupon rate. After all prior classes are repaid, the Z-bond amortizes based upon its final principal amount. Accordingly, the Z-bond acts like a zero coupon security while the coupon paying classes are outstanding.

CMOs revolutionized mortgage investing by offering investors different maturity choices along the yield curve. A typical CMO segments cash flow from 30-year mortgages (or mortgage securities) to create separate bond classes, which may have stated maturities of 5, 10, 20 and 30 years, respectively. However, due to the expected prepayment of underlying mortgage loans, average lives might be 2, 5, 10 and 20 years. These shorter average lives permit pricing off a treasury security with that maturity. Investors can choose the class that fits their desired maturity.

While the CMO provides greater investment certainty, the rating agencies assume a "worst case" scenario in determining the amount that can be borrowed or funded from any particular collateral pool. This amount, or "bond value," is strictly limited so that the CMO is self-supporting under *any* mortgage prepayment or reinvestment rate scenario. The differences between the rating agencies' highly conservative assumptions and actual pricing assumptions produce surplus cash flows or "residuals." These residuals are also called CMO equity when the "owner's trust" structure is used for CMO issuance.

"Owner's trust" CMOs—benefits for mortgage bankers

The differences between the highly conservative assumptions of the rating agencies and the actual CMO pricing assumptions that give rise to the residual cash flows have been analyzed by practitioners since the first CMO was created. The initial focus of the analysis was to determine residual present value under a variety of prepayment and reinvestment rate scenarios. The subsequent focus was to determine the optimal structure for liquification of CMO residuals to improve CMO efficiency.

Under current accounting treatment, CMOs are considered debt obligations when the residual component has a non-trivial present value. Accordingly, CMOs require balance sheet presentation in most instances. This has inhibited a significant number of potential issuers of CMOs; in particular, mortgage bankers. The mortgage banker generally needs asset sale accounting treatment as well as cash "up front" from residual liquification.

Like issuers, buyers of CMOs have their own accounting and investment considerations. To appeal to the largest possible universe of buyers, the CMO residual should qualify under broad real estate and mortgage investment statutes. In addition, the buyer would prefer off-balance sheet treatment of the security, just like the mortgage banker.

CHART 1

CMO Volume By Type of Issuer

($ Billions, Through 9/30/86)

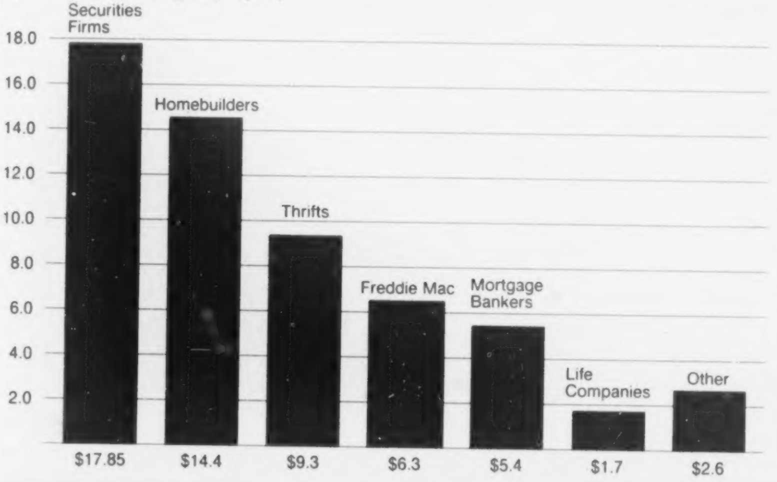
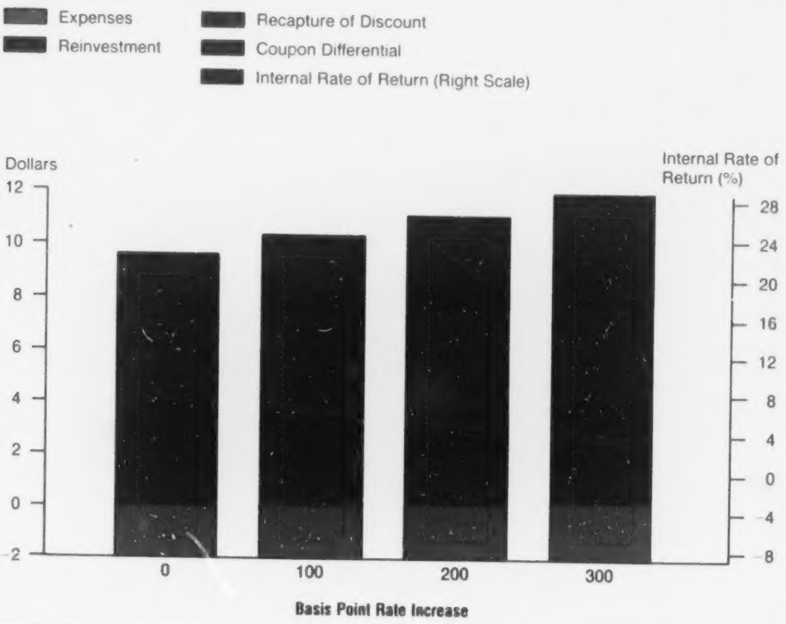


CHART 2

Components of CMO Residuals



In response to some of these problems, Morgan Stanley successfully developed and sold the first issue of CMOs using an "owner's trust" structure. This issue debuted in the November 1, 1985 offering by Morgan Stanley Capital I, a wholly owned affiliate of Morgan Stanley.

The owner's trust structure is functionally identical to other CMO issues in that the bonds are debt obligations. The residuals represent ownership interests in a trust. Just like other CMOs, these residuals result from highly conservative rating agency assumptions required for structuring AAA-rated securities. The owner's trust CMO has, in its short life, become a preferred structure for many issuers. The accounting profession views a sale of residuals as converting a financing to a sale of assets. From an investor's point of view, purchase of less than a 50 percent interest in the CMO equity generally does not require balance sheet treatment of the assets and liabilities of the trust. Importantly, the sale of residuals releases the excess cash flow so that all of the proceeds from the issuance of CMOs are received up front.

The power of the owner's trust CMO results from the ability to securitize and liquify the residual. Buyers of these residuals purchase undivided interests in a trust that owns real estate assets (i.e., mortgages or mortgage securities). For many classes of investors, such as thrift institutions, this form of investment is well understood and established. In particular, residuals represent ideal investments for thrift institutions. They generally have short average lives, superb credit (based on AAA ratings), and high yields. In fact, they even have attractive "defensive" characteristics

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compared to traditional fixed income securities. Residual investments generally perform better when interest rates are high and mortgage prepayments are low. This is generally the environment when traditional fixed income securities do poorly.

Components of CMO residuals

While residuals have an interest, principal and reinvestment component, it might be instructive to analyze the composition of residuals. Chart 2 sets forth a graphic representation of how the components of CMO residuals will vary with increases in interest rates.

- *Excess interest*—The difference between the highest coupon of the CMO classes and the net rate on premium collateral produces excess yield. The rating agencies assume that premium collateral will prepay immediately; hence, as a practical matter, the maximum bond value is 100 percent of the mortgage's outstanding principal amount. In the case of conventional whole loans, the excess yield is determined at the time of bond pricing when the high CMO coupon is set. The servicing fee is accordingly increased, thus incorporating excess interest into servicing income.
- *Coupon differential*—The difference between the actual CMO coupons and the highest CMO coupon used in calculating bond value. In a typical positive yield curve, the shorter maturity CMOs have lower coupons. This generates interest differential as long as these lower rate CMO classes are outstanding. For example, if a CMO had two classes, one at 9 percent and the other at 8.5 percent, the interest differential would be .5 percent for the actual life of the 8.5 percent class.
- *Recapture of "discount"*—If the net rate of the mortgage collateral is less than the highest CMO coupon rate, the bond value is less than 100 percent of par. Thus, the amount borrowed through the CMO is less than the mortgage loan balance. If the mortgagor prepays in full, the current bond value balance is less than the amount prepaid. For example, assume a $100,000 mortgage secures a CMO with a $95,000 initial bond value. One year later, the mortgagor pays off the loan balance of $99,900. The mortgagee then pays off the outstanding bond value balance of $94,910, creating a recapture of $4,990 in bond value discount. Unless the mortgage never prepays, there is always a difference between the outstanding balance of bonds and mortgages with discount collateral.
- *Reinvestment income*—Most of the funds (mortgage interest, scheduled principal and prepayments) being held for distribution to the bondholders (or for various reserve funds) are invested in guaranteed investment contracts (GICs) or in eligible investments, which include obligations backed by the full faith and credit of the United States government. The difference between the actual income from reinvestment and the assumed reinvestment allowed by the rating agencies when determining the bond value may be a significant component of total residual value, particularly if interest rates are high or rising.

> "REMIC specifically defines and rationalizes the CMO residual."

- *Unused reserves and prepaid insurance*—To the extent reserves or insurance are required for the CMO to receive a AAA rating (particularly in the case of whole loans), portions of the reserves may not be used or become unnecessary to ensure the economic viability under the rating agencies guidelines at some future date. For instance, if a mortgage having a buydown reserve balance of $5,000 prepays, the remaining funds accrue to the residual holders.

These are the key components that must be understood in order to model the CMO residual. Before discussing how to model residuals, another issue must be addressed. Who receives the residuals? The issuer of the CMO debt obligation is the initial recipient of all the residuals. Some CMO issues provide for distribution of residual cash flow to an affiliate of the issuer, or utilize the residuals to establish certain reserve funds. Other CMO issues use residual cash flow to accelerate payment to CMO holders.

The cost of administering the CMO is borne by the issuer. The cost of administration includes regular accounting and legal fees to cover various compliance functions, trustee fees for handling the physical mortgage files or securities and the cost of servicing the CMO. Many issuers include an estimate of the administration cost when computing the bond value. Otherwise, bond administration fees are deducted from the residuals. In either case, whenever there are insufficient funds to cover these expenses, the issuer (or purchaser of a residual) may be responsible and can use the residuals available for such expenses. In any case, the rating agencies will review the assumptions behind expenses and bond administration to validate that future shortfalls do not jeopardize the integrity of the CMO issue.

Residual analysis

Residuals must be analyzed on a case-by-case basis. In general, it will be helpful (or necessary) to group collateral by common characteristics in order to capture the impact of different assumptions. For instance, in the universe of Ginnie Mae 9s, remaining terms range from 30 years (new) to approximately 22 years (seasoned). Knowing the specific weighted average remaining terms is important because seasoning affects location on the Public Securities Administration prepayment curve. In general, residual analysis can be viewed as a five-step process:

- Group the CMO collateral by common characteristics (type of mortgage security, coupon, remaining term, etc.)
- Determine reinvestment rates (or guaranteed rate if a GIC is used) for interim cash flows. Monthly mortgage payments will be reinvested prior to distribution to CMO holders on a quarterly or semiannual basis.
- Determine appropriate bond administration expenses that require provisions (unless specifically provided

for in the bond value calculation).

- Generate the net cash flows at different prepayment assumptions.
- Compute the net present value (NPV) and duration of the residual cash flows at different prepayment speeds and discount rates. Most residual analysis is summarized through the internal rate of return (IRR) calculation.

Investment characteristics

Residuals have attractive characteristics to a variety of investors. Four important features are:

- High credit quality (based upon AAA-rated CMOs).
- High yield (versus other securities with comparable duration).
- Short duration (although the cash flows generally have a long "tail").
- Defensive or counter cyclical performance versus other fixed income securities.

> "The CMO is an extension of ongoing efforts dedicated to securitizing mortgage cash flow."

Several of these points need further clarification. Depending upon the shape of the yield curve (and related CMO spreads off the benchmark treasury), the coupon differential is concentrated in the early CMO classes. As mortgages prepay and bonds are retired, this differential is curtailed. Ultimately, the residual may become negative at a crossover point, as certain expenses are assumed to exist for the life of the issue. Calculation of NPV and IRR at various prepayment speeds should incorporate the negative cash

TABLE 3

CMO Economics and Structure (All Dollar Amounts in Thousands)

Bond Information

1)

Class	Par Amount	Percent of Issue	Coupon	Stated Maturity	Average Life		Treasury Yield	Price	Under-Writing Fee	Average Life at PSA Speeds: 0%	25%	400%
1	64,479	32.4%	7.800%	11/01/02	3.5	+100 off 3-yr	6.680%	99.909	0.600%	12.4	9.6	1.1
2	56,550	28.4	8.150	11/01/16	5.6	+110 off 5-yr	7.000	99.891	0.600	7.0	5.6	5.6
3	54,772	27.5	9.050	02/01/06	10.9	+185 off 10-yr	7.540	97.669	0.700	17.3	15.3	3.6
4	23,483	11.8	9.550	11/01/16	19.8	+240 off 20-yr	8.200	84.888	0.825	24.4	23.5	12.1
	199,284				10.7			97.518	0.654%			

Residual Information

2)

Prepayment Assumption	Net Investment	PV of Residual at 15%	NPV to Issuer	Rate of Return to Issuer	Rate of Return to Residual Buyer*	Duration of Residual*	Years of Positive Residual
0%	14,558	17,758	3,201	20.14	25.69	3.31	29.00
25%	14,558	16,065	1,507	17.71	23.37	3.21	29.00
50%	14,558	14,550	(8)	14.98	20.68	3.15	28.75
100%	14,558	12,176	(2,382)	9.34	15.00	3.07	27.50
150%	14,558	10,586	(3,972)	4.14	9.75	3.03	25.00
200%	14,558	9,500	(5,058)	N/A	5.03	2.90	22.00
250%	14,558	8,688	(5,869)	N/A	0.14	2.45	18.75
300%	14,558	8,075	(6,482)	N/A	N/A	0.00	16.25
400%	14,558	7,218	(7,340)	N/A	N/A	0.00	12.25

3)

Prepayment Assumption	NPV at 0%	NPV at 5%	NPV at 10%	NPV at 15%	NPV at 20%	NPV at 25%	NPV at 30%	NPV at 35%	NPV at 40%
0%	31,199	17,887	10,294	5,583	2,452	253	(1,362)	(2,591)	(3,556)
25%	23,438	13,526	7,656	3,889	1,310	(545)	(1,935)	(3,011)	(3,866)
50%	17,489	10,000	5,411	2,374	240	(1,330)	(2,528)	(3,471)	(4,229)
100%	9,456	4,987	2,053	0	(1,510)	(2,665)	(3,576)	(4,312)	(4,918)
150%	4,842	1,955	(86)	(1,590)	(2,739)	(3,642)	(4,372)	(4,972)	(5,475)
200%	1,988	11	(1,504)	(2,676)	(3,602)	(4,348)	(4,960)	(5,472)	(5,906)
250%	43	(1,364)	(2,537)	(3,488)	(4,260)	(4,895)	(5,424)	(5,872)	(6,255)
300%	(1,291)	(2,343)	(3,297)	(4,100)	(4,768)	(5,326)	(5,796)	(6,197)	(6,542)
500%	(2,935)	(3,615)	(4,325)	(4,958)	(5,500)	(5,961)	(6,356)	(6,695)	(6,989)

* Assuming purchase of entire residual for $12,176 to yield 15% at 100% PSA

flows in distant years of the CMO. Although CMO issuers may be able to call any classes still outstanding prior to this crossover point, the rating agencies will not permit an issuer to structure an issue given this assumption.

CMO residuals have a much higher percentage of their total return based upon reinvestment income versus other fixed income securities. Total return is also highly sensitive to prepayment speeds. High interest rates have the dual effect of decreasing mortgage prepayments and increasing reinvestment income. Accordingly, the coupon differential is earned over a longer time period and interim cash flows are reinvested at higher rates. In a high or rising interest rate scenario (i.e., a "bear" market), residuals are an excellent defensive instrument to offset the usual deteriorating performance of traditional fixed income securities. Although discount recapture from principal prepayments would tend to offset this, prepayment of discount mortgages in such an environment would be unlikely.

Table 3 illustrates the interaction of these variables. This exhibit shows the residual analysis (Sections 2 and 3) relating to a specific CMO issue (Section 1). Section 2 sets forth the residual's reaction to prepayment speeds. It is clear that present value and rate of return decline as prepayments accelerate. Also, the number of years of positive residual cash flow is reduced. The matrix in Section 3 illustrates clearly how, in this particular example, higher prepayment speeds erode present value. This would generally be true, even with discount mortgage collateral, since the reinvestment component of total return is so dominant.

Residuals under REMIC

The Real Estate Mortgage Investment Conduit or REMIC structure authorized by the Tax Reform Act of 1986 has already brought significant changes to the mortgage securities market. Several issuers took immediate advantage of REMIC's attractive provisions in late 1986 by pricing offerings to close after the January 1, 1987 effective date. For the first time, issuers will have the option of treating the issuance of multiple class mortgage securities themselves as sales for tax purposes. As a result, REMIC will permit multiple class mortgage security issuers to have the choice of structuring transactions as either financings or sale of assets for accounting purposes without cumbersome tax considerations. This legislation will improve the efficiency of CMO and related mortgage security issues.

REMIC specifically defines and rationalizes the CMO residual. The market liquidity and investor base for residuals will undoubtedly increase. As a defined security, residuals have increased status and reduced tax and legal investment uncertainty. The specific REMIC provisions which enhance the legal and tax status of residuals are:

- Residuals under REMIC, unlike owner's trust residuals, are freely transferable.
- Residuals are now treated as qualifying mortgage assets for purposes of the special bad debt reserve deduction for thrifts.
- Residuals are qualifying real estate assets for REITs.
- Residual income is partially tax-exempt to pension plans whereas income from owner's trust residuals falls under the unrelated business taxable income rules.
- Without minimum equity requirements needed to satisfy debt tests for tax purposes, residuals can be structured more efficiently.

Mortgage bankers will undoubtedly be significant issuers of mortgage securities under REMIC. REMIC addresses the mortgage banker's two greatest stumbling blocks in creating mortgage securities: obtaining asset sale accounting treatment and maximizing cash proceeds. Efficiently structured residuals can qualify more readily for asset sale treatment under financial reporting requirements. Greater liquidity and a broader investor base will facilitate residual sales and maximize cash proceeds. Understanding mortgage cash flows and the rating agency considerations employed in structuring AAA-rated securities can proceed without tax distractions. Analysis of all the cash flows and their permutations will permit liquification beyond the highly conservative assumptions of the rating agencies. The result will be maximum capital market efficiency. ☐

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MORTGAGE MARKET TRENDS

Economic statistics released during the first two weeks of December suggest that the expected strengthening of the economy during the fourth quarter is underway. At the time of this writing (mid-December), Mortgage Bankers Association (MBA) economists believe that real gross national product (GNP) should increase at an annual rate of 3 to 3½ percent during the final three months of 1986, up from a revised 2.9 percent during the July-through-September period. However, this strengthening is largely the result of temporary factors and is very likely to be followed by a weakening economy during the first half of the new year. Under such circumstances, we anticipate further declines in interest rates through the middle of 1987, helped along by at least one cut in the Federal Reserve's discount rate. Indeed, it appears that this decline in interest rates has begun, with long-term rates down roughly 20 basis points from the relatively stable levels of November.

Economic indicators released during late October and the first half of November were mixed and raised some doubt as to whether or not a fourth-quarter strengthening would materialize. However, data released in late November and the first half of December suggest that this strengthening is indeed occurring. Non-agricultural payroll employment rose by a healthy 250,000 during November after having increased by 260,000 in October. These increases included gains in manufacturing of 35,000 in November and 23,000 in October. Moreover, average weekly hours also increased in November, resulting in a significant increase in aggregate hours worked. In fact, at an annual rate, the index of aggregate weekly hours of production or non-supervisory workers on private non-agricultural payrolls for October and November was up 3 percent above the average level for the third quarter. Retail sales in November rose a moderate 0.5 percent above the October level. Spending for goods other than autos rose 0.9 percent compared to 0.3 percent in October. Moreover, domestic auto sales increased during the last 10 days of November, probably induced by the change in tax law which takes effect January 1.

Activity in the one- to four-family housing area is holding up reasonably well. Starts of one- to four-family units in October were up 2.6 percent above the September level while single-family resales maintained their pace of nearly 3.8 million units. The multifamily area, however, continues to be plagued by both high vacancy rates and pending tax reform with starts declining 7 percent further to 462,000 units. Building permits issued declined moderately in October for both one- to four-family units and multifamily units.

Price statistics recently have been less favorable than they were earlier in the year, when declines in energy prices were large enough to produce an overall reduction in prices of both producer-finished goods and consumer goods and services. Nonetheless, nothing worrisome has developed on the inflation front. In October, producer prices of finished goods other than food and energy rose 0.7 percent, but this rather large increase stemmed partly from the introduction of 1987 models of domestically-produced cars and light trucks. In November the increase in this index declined to 0.3 percent, returning to the moderate rate of increase of earlier months.

For the first half of 1987, MBA economists expect economic growth to slow to around a 2-percent annual rate. Consumer spending will be markedly slower than in the first three quarters of 1986, as the personal savings rate increases to more normal levels. Commercial building outlays should begin declining again relatively soon, and are expected to continue dropping throughout most of next year. Reduced growth in federal expenditures, reflecting congressional efforts to restrain spending, will also act in the short run to slow down overall economic expansion. Rising net exports and increased inventory investment are expected to be sources of strength next year, but not enough to induce a significant pickup in the overall pace of expansion. Indeed, auto inventories have risen substantially since the end of September, and have already led to moderate cutbacks in auto production.

There is no reason to expect major new developments regarding inflation in the near term. Import prices have been increasing a bit faster recently, but not enough to put major upward pressure on domestic inflation. The OPEC countries have now adopted a price objective of $18 a barrel. Achievement of that objective, however, will require production cuts that may not be acceptable to individual OPEC countries. Even if a price of $18 a barrel could be made to stick, it is unlikely that the underlying inflation rate would break out of the 3- to 4-percent range in evidence recently. Wage rate increases are likely to remain comparatively low in an environment of slow to moderate growth while competitive pressures in product markets are expected to remain fierce.

Growth in the 2- to 3-percent range will be less than Federal Reserve officials are likely to view as satisfactory. With inflation remaining under good control, the dollar having strengthened recently and the Japanese discount rate having been reduced, the Fed has leeway to take additional easing steps if they choose to. Additional easing actions will be taken once it becomes fully evident that the improvement in the pace of expansion since mid-1986 has been of modest dimensions. Such evidence should be in hand before the end of the first quarter of next year, if not earlier.

It would not be surprising to see two additional cuts in the Federal Reserve's discount rate before the middle of 1987. If this occurs, short-term interest rates will fall by a full percentage point. Long-term rates would likely decline considerably less, by perhaps half a percentage point. Nonetheless, this would bring conventional mortgage rates down to the 8½- to 9-percent level by the middle of 1987.

Such a decline in mortgage interest rates should help to hold single-family house sales and housing starts near current levels through most of the year. Specifically, MBA economists expect one- to four-family housing starts to range around 1.25 million next year while single-family resales should stabilize in the 3.25- to 3.5-million range. Multifamily starts, however, are expected to decline further, probably to around 400,000 units in 1987. ☐

Richard W. Peach
Senior Economist
December 15, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JUN	184	132	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	164	117	47	1,795	1,275	520	144	100	44	1,673	1,147	526
SEP	154	108	46	1,664	1,161	503	152	103	49	1,603	1,144	459
OCT	155	109	46	1,628	1,171	457	145	103	43	1,565	1,109	456
NOV	117	84	33	[illegible]	1,164	434	108	71	37	[illegible]	[illegible]	[illegible]
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
11 MONTHS												
1986	1,693	1,185	508				1,624	1,101	523			
1985	1,621	1,094	527				1,606	1,010	596			
1984	1,616	1,093	523				1,575	1,005	570			
1983	1,595	1,112	483				1,497	970	527			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JUN	30	35	70	48	283	300	768	501	28	30	66	50	274	286	728	504
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	692	457
AUG	34	30	60	40	321	293	707	474	25	28	52	39	272	289	653	459
SEP	29	27	61	37	280	270	702	412	30	28	53	41	297	258	597	451
OCT	27	28	60	41	250	238	678	462	27	27	52	40	260	249	598	458
NOV	[illegible]	19	40	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	18	21	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
11 MONTHS																
1986	275	276	693	449					264	272	634	454				
1985	235	227	726	453					242	220	690	453				
1984	190	232	815	413					186	200	760	430				
1983	159	207	873	357					153	179	806	360				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
MAY	330	75	336	5.3	224.3	99.5	32.9	91.9	1,132	648	484	148	94	54
JUN	338	66	340	5.8	226.7	102.4	32.8	91.5	1,153	665	488	150	103	47
JUL	336	57	349	6.1	229.5	104.4	32.6	92.5	1,157	675	482	151	101	50
AUG	341	52	354	7.0	232.5	105.5	32.5	94.5	1,164	682	482	159	109	50
SEP	317	60	359	5.9	232.1	106.6	31.8	93.7	1,154	678	476	157	112	45
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
10 MONTHS														
1986	3,027	652										1,434	980	454
1985	2,847	590										1,398	956	442
1984	2,484	559										1,369	939	430
1983	2,337	529										1,127	819	308

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type
(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
6 MONTHS										
1986	239,773	57,049	90,581	77,779	14,364	177,399	52,855	73,356	49,840	1,348
1985	154,435	27,409	64,260	51,319	10,477	101,481	25,544	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

	5+ UNITS					NONRESIDENTIAL				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,541	489	1,363	508	218	9,420	224	1,474	5,480	2,242
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
6 MONTHS										
1986	13,009	2,676	7,843	2,975	1,515	49,365	1,518	9,382	26,964	11,501
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

	ISSUED DURING MONTH					OUTSTANDING				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	$26,031	$7,695	$12,913	$3,000	$2,423	$ 96,650	$13,930	$47,353	$18,327	$17,040
FEB	31,132	7,954	13,907	6,680	2,591	108,898	16,153	44,355	30,732	17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,521	24,409	56,406	56,531	23,175
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
6 MONTHS										
1986	259,843	65,568	112,989	59,193	22,093					
1985	114,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
YEAR AND MONTH	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
MAY	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,878	64	3,971	27	1,942	62	4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
10 MONTHS												
1986	2,866	1,696	376	794	1,403	97,202	639	39,158	274	19,695	490	38,349
1985	1,858	744	202	912	1,040	68,498	268	15,630	148	10,006	624	42,862
1984	1,592	378	169	1,045	1,175	75,859	181	9,620	172	11,022	822	55,217
1983	1,690	680	295	715	1,066	63,857	322	16,282	237	14,920	507	32,655

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
MAY	$3,538	$1,978	$67,312	$4,491	$9,857	$10,612	$8,947	$8,162	$4,863	$5,872
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL	3,270	3,343	76,197	6,106	8,585	7,863	8,518	8,118	14,246	10,226
AUG	3,840	3,800	81,060	7,079	12,722	13,707	10,458	10,127	10,177	6,813
SEP	4,248	4,649	86,359	7,357	n.a.	n.a.	n.a.	n.a.	36,333	12,861
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	20,225	21,510	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
1984 TOTAL	21,006	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
10 MONTHS										
1986	29,905	25,942	—	49,437	66,726	70,866	58,255	55,821	129,215	76,434
1985	17,168	18,224	—	15,587	27,988	31,569	26,802	24,088	52,873	36,098
1984	16,099	13,463	—	9,903	17,153	18,166	11,380	10,451	29,927	24,355
1983	16,139	14,006	—	11,108	21,815	23,168	14,831	14,119	62,033	44,096

* FHLMC Year-to-date totals are for eight months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
JUN	9.98%	10.38%	10.39%	10.15%	10.20%	8.60%	10.050%	11.62%
JUL	10.01	10.28	10.32	10.30	10.26	8.29	9.813	12.02
AUG	9.80	9.88	9.92	10.26	10.26	7.96	9.455	11.45
SEP	9.90	9.96	9.95	10.17	10.08	7.86	9.588	12.16
OCTp	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

CURRENT SECONDARY MARKET YIELDS

SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
JUN	9.57%	9.71	9.75	9.65%	7.80%	6.27%	6.71%
JUL	9.32	9.48	9.49	9.57	7.30	5.86	6.33
AUG	9.11	9.21	9.24	9.51	7.17	5.55	5.92
SEP	9.28	9.27	9.32	9.56	7.45	5.35	5.68
OCT	9.05	9.14	9.18	9.48	7.43	5.26	5.68
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
JUN	41	177	191	195
JUL	50	202	218	219
AUG	29	194	204	207
SEP	34	183	182	187
OCT	49	162	171	175
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields

[5] Federal Home Loan Mortgage Corp. Existing Construction only

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year-to-date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

MORTGAGE BANKING

FEBRUARY 1987

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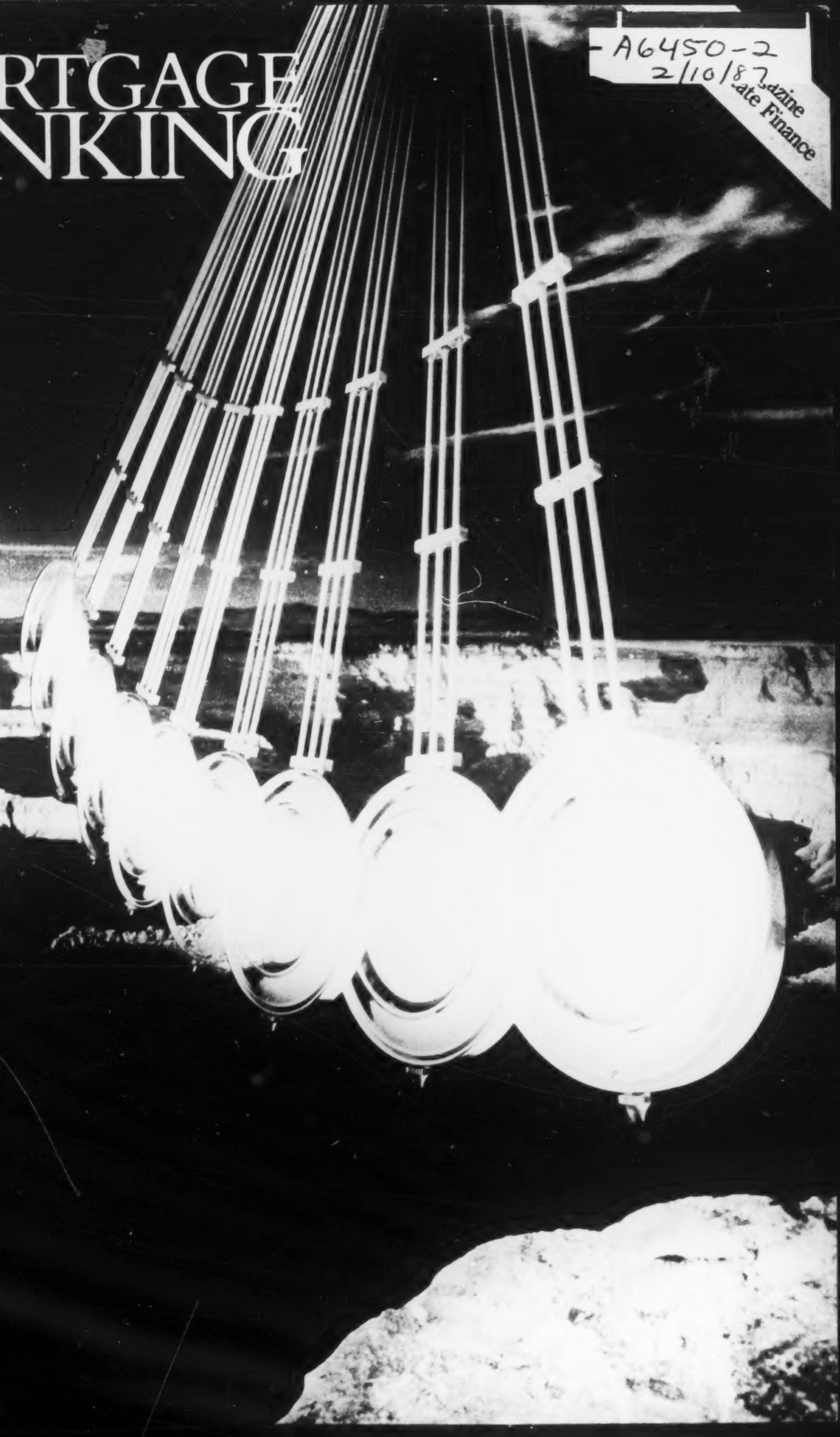

MORTGAGE BANKING

VOLUME 47 NO. 5
FEBRUARY 1987

ARTICLES

PAGE 8
MANAGING INSURED RISK: WHICH WAY WILL THE PENDULUM SWING?
Roger F. Blood

This article examines the mortgage insurance industry from an underwriting, risk management, marketing and service-responsive standpoint. Will the industry experience a further swing of the pendulum, either to a more conservative extreme, or back toward a more accommodating posture? The author identifies the forces operating to warrant further changes.

PAGE 22
MORTGAGE INSURANCE: GEARING UP FOR NEW CHALLENGES
William H. Lacy

The mortgage insurance industry is responding to a changing environment. MIs are trying to leave behind the adverse effects of unprecedented claims levels in the early 1980s and are preparing to face the new challenges ahead. MGIC's president outlines his company's goals.

PAGE 31
MARKET LEADERSHIP THROUGH GROWTH MANAGEMENT
Diane L. Cortes

This author believes that growth management for the real estate finance industry will require a deliberate slowing in the acceptance of new business in the short run. However, some lenders will be unwilling to sacrifice short-term profits for long-term benefits. The opportunity to achieve market leadership will be open to those who choose to manage their growth, according to this article.

PAGE 39
SUPERFUND: LENDER LIABILITY
Robert A. Weissman

Lenders face potential liability for hazardous waste found on property financed through mortgage loans. Today counsel to lenders must be well-versed in environmental law as well as real estate law.

PAGE 47
FHA-MI: A MARKETPLACE PERSPECTIVE
Brian Chappelle

During 1986, FHA had its greatest year ever. According to this article, FHA received approximately 2 million applications surpassing all previous records by more than 50 percent. The MIs' competition with FHA should be decided in the marketplace and not by OMB. As long as the marketplace decides, the American homebuyer will benefit.

PAGE 55
HOW MOODY'S RATES MIs
Michael F. Molesky

This article details Moody's approach to rating mortgage default insurance. Data from 1985 seem to indicate that because of tighter underwriting standards, it may be the best first-year performance in more than 14 years.

PAGE 73
PRICING MORTGAGE INSURANCE FOR ADEQUATE RETURN: TERRITORIAL RATING
Jeffrey L. Kucera

PMI has established rate differences by state. It also introduced a major change in 1986 with the performance incentive program. This program is a form of experience rating where a lender is offered a discount based on its better than average experience. PMI believes that territorial rating and the performance incentive program are major steps forward in the pricing of mortgage insurance.

PAGE 78
THE ECONOMIC AND FINANCIAL OUTLOOK FOR 1987
Lyle E. Gramley

MBA's chief economist, Lyle E. Gramley, presents *Mortgage Banking's* annual economic forecast. It does not seem likely that the economy will emerge from the relatively moderate growth path that has been in existence since mid-1984. Gramley predicts that the economy will grow at around a 2½ percent rate during the four quarters of 1987.

PAGE 89
1986: A YEAR OF NEW RISK
Anthony W. Schweiger

Meridian Mortgage Corporation's executive vice president overviews some of the major developments in the mortgage banking industry during the past year.

PAGE 92
AN INTERVIEW WITH JOE C. MORRIS

The new chairman of the U.S. League shares some of his plans for the coming year in this exclusive interview with *Mortgage Banking* magazine.

PAGE 100
BUSINESS BASICS MORTGAGE PROTECTION SERVICE
C. Richard Hughes

This article explains what the different types of real property-related insurance are. Customers may have one or more of these coverages and understanding what they are and how they differ will help the customer know what protection he or she currently has.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 100
PEOPLE 104
BOOKS 109
SECONDARY MORTGAGE MARKETS 111
MORTGAGE MARKET TRENDS 113
AD INDEX 122

HOW MOODY'S RATES MIs

Mortgage insurance (MI) is a highly specialized industry. The MI companies' product, mortgage default insurance, stands in sharp contrast to all other insurance products. Mortgage defaults are influenced not only by random events, which disrupt borrower income, but also by adverse regional and national economic conditions. The normal loss cycle for these companies is considerably longer than that for property casualty products and is directly related to the housing market and general business cycle. Yet, the fundamental risk that this insurance is intended to cover, namely, national economic catastrophe, is what sets the industry apart from all other types of insurance and necessitates very special analysis.

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ILLUSTRATION BY DENNIS WALSTON AND MARIT GRETZ

■ Given the unusual fundamental risk to be covered, the use of traditional measures to assess an MI company's potential success or failure in meeting all potential claims is doomed. Reviews of trends in loss and expense ratios, risk-to-capital ratios simply do not provide enough information to assess

Michael F. Molesky

how such companies would perform under stress. One approach used by many analysts is to assume that loan performance would mirror what was experienced in the 1930s depression. However, such assumptions ignore several important considerations:

- The information available from the 1920s and 1930s is limited to those concerns that survived the Depression. Foreclosure frequencies and losses may have been higher for the many companies that failed.
- Today's financial market is of a very different structure from the 1930s with deposit insurance and a Federal Reserve. There are also ancillary federal agencies specifically set up to assist the mortgage market. In addition, the welfare system is capable of substantially softening a major decline in the economy.
- Today's loan instruments are sharply different from loans in the 1930s. Such loans tended to be short-term loans with balloon payments which had to be refinanced to avoid foreclosure—a difficult feat during a period of failing financial institutions. The lack of available financing had a decided impact on foreclosure rates of the early 1930s.
- There are substantial differences in the inherent credit risk of loans by type, loan-to-value (LTV) and location—all of which vary from one company to another. To ignore such differences and apply standard performance assumptions to each company would result in little differentiation in each company's ability to perform.

Moody's approach to rating the claims paying ability of private mortgage insurers entails an extensive, in-depth examination of the individual operations of each company. In addition, Moody's applies a very unique approach to qualifying the risks associated with a company's risk exposure. The firm's history of risk management and its experiences are examined in light of the interaction of the loan portfolio's risk characteristics and economic forces over time.

> “Original loan-to-value has been a particularly sensitive measure of relative risk because it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan.”

Michael F. Molesky is an assistant vice president for the structured transactions group within the corporate department of Moody's Investors Service in New York City.

To do this requires an on-site visit with key management officials. An initial meeting will often cover the following topics:

The company corporate structure

- Structure and company position
- Strategic planning and outlook
- Non-insurance activities
- Management experience

Operating strategy and results

- Principal lines of business and products
- Distribution systems and marketing
- Commission structures
- Competition
- Management control
- Underwriting standards, pricing
- Profitability

Reserves

- Reserving policies
- Management and actuarial control
- Reserve evaluation, loss experience, adequacy testing

Investments

- Investment policies and strategies
- Coordination with risk exposure
- Portfolio quality
- Portfolio performance

Taxation

- Company's tax position, including presence of deferred taxes, tax carryforwards or carrybacks
- Intercompany tax treaties; transfer or sale of tax benefits

Reinsurance ceded and assumed

- Strategies for use of reinsurance
- Underwriting policies
- Major amounts ceded and assumed companies
- Risk exposure limitations and control

This intense interview session fills in the missing links needed to more fully understand the changes in the company's financial statements. Moody's collects all of a company's annual financial statements and computerizes key sections of it. A cash flow model unique to the company's operations will be developed from the combined information.

Moody's recognizes distinct differences in the performance of individual MIs because of different risk portfolios and exposure to different local economic influences. Over half of the industry developed during an economic era which was conducive to unusually low default rates. It is necessary to separate out the influences of price appreciation and other market factors to truly understand how a company might operate under different economic stress situations, especially under extreme economic conditions. Therefore, Moody's develops a loss model which qualifies the risks unique to a company and which can project losses under a variety of economic conditions. Most importantly, the model development requires only assumptions about economic conditions. Moody's does not make any assumptions about foreclosure frequency or loss severity. These components of loss are derived from the loss model.

Moody's loss models

As an essential part of its rating process, Moody's requires that a company provide unpublished data on a special matrix tape format: Originations, insurance, and risk-in-force by 10 or more different loan types, by four loan-to-value groups, by year of origination, and by state or U.S. territory. Moody's also requires a set of data referred to as the claims-survivorship data, also by loan type, occupancy status, loan-to-value, year of origination and state. These data track the number of loans outstanding by year of origination and depict claim terminations by risk class and year in which they occur and the average claim, net of salvage.

Moody's uses the data, together with information about local economies over time, to model the claim terminations by occupancy status, loan type and loan-to-value. By this means, Moody's can describe an economic stress in terms of economic conditions and allow the performance of the individual firm to dictate the frequency of default and loss severity it might suffer, should such a scenario actually occur.

For companies with little experience in a particular loan type, industry models are substituted to avoid forecasting errors due to insufficient degrees of freedom. However, with each annual update, there is a multiple increase in the number of degrees of freedom because the data are arranged by year of origination and four loan-to-value groups. Consequently, most companies will have sufficient observations for individual loan-type models within a few years. Presently the most accurate, individual company loss models are those for the standard fixed-payment conventional loan.

Losses incurred, losses paid and risk outstanding, as projected by the loss model, are meshed with the cash flow model to test the adequacy and quality of the company's own reserves as well as the adequacy of support arrangements and enhancements. Thus the operations of a company, the strengths of its investment portfolio and the amount of risk and quality of risk taken on by the company, together with any enhancement arrangement are viewed on their own merits in the face of economic stress. Through the detailed process, Moody's is essentially reunderwriting the company's book of business.

Claims-paying ability

Moody's puts the company through two stress scenarios in order to evaluate the firm's claims-paying capacity: first, a depression-like scenario, and second, a stagflation scenario that is meant to stress the performance of adjustable rate mortgage (ARM)-type mortgages, which have swiftly become a major component of the industry's risk exposure. These tests emphasize not only the company's individual capacity to pay claims but also the sufficiency of additional enhancements or guarantees.

> "Net equity position, over time, has been established as the key determinant of default probability by several studies of Federal Housing Administration (FHA) data and has been confirmed for conventional loans by other researchers using loan data from MGIC."

Depression stress test

Moody's uses a depression stress test as an important tool to test the claims-paying capacity of a company's resources plus enhancements. Through the use of the modeling approach, Moody's imposes no assumption on the company's performance, but rather lets the company performance models interact with economic forces comparable to those that characterized the last depression in determining the company's claim frequency and loss severity and remaining outstanding risks. These estimates, when injected into the cash flow model, determine how well the company is able to pay all claims and remain solvent.

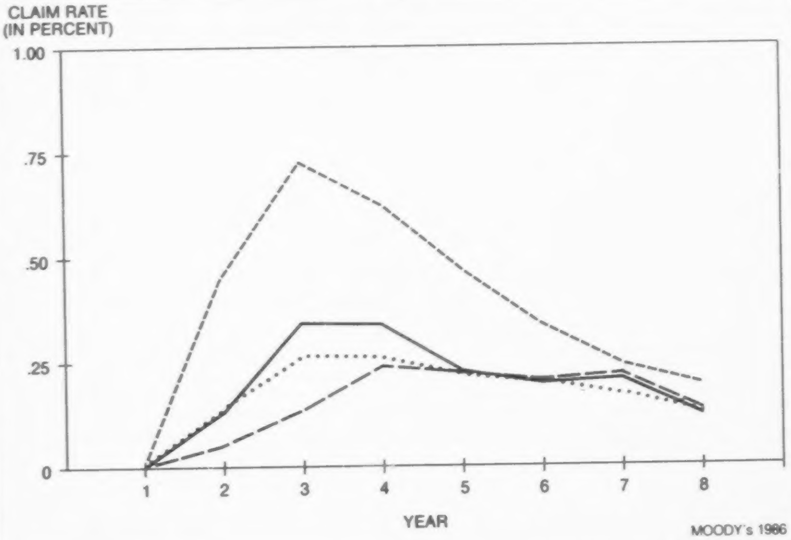
We describe an eight-year depression scenario that attempts to match known economic influences. Key factors are listed in Table 2 for national averages.

Under the depression scenario, Moody's assumes that, with home prices falling sharply, mortgage insurance companies would cease writing new insurance, preferring to wait until the market turned around. Precedents for cessation of new business in certain local markets abound from recent experience. Some firms have stopped writing new insurance in cities such as Houston, while others have suspended operation in whole states, such as Wyoming and Alaska.

Moody's attention to the mortgage insurance industry is an ongoing concern. As the fortunes of various local markets change, and as the companies add new policies while existing ones mature, the capacity of individual companies to pay claims changes. More-

GRAPH 1

EVER TO DATE CLAIM RATES
ALL LOAN TYPES
1957-1977



over, with each year, there is more performance information available to assess the potential risks inherent in the newer mortgage loan instruments. To stay abreast of changing market conditions and trends, Moody's reviews the financial statements of each company on a quarterly basis. On an annual basis, Moody's runs a full review which includes the collection and analysis of the detailed data base used in the formulation of the loss model. Some of this previously unpublished data is available in Moody's annual and quarterly updates on the industry.

Appendix risk analysis

Detailed analysis of risk exposure is a key process in Moody's evaluation of the mortgage insurance industry. It is essential in measuring the relative strengths and weaknesses of the major firms in the industry. A mortgage insurance company's risk exposure reflects the combination of many different elements, all of which relate directly to the net equity position of loans within a portfolio and/or the ability to meet scheduled changes in monthly payments. Major risk elements include the following:

- Geographic dispersion of business;
- Loan-to-value mix;
- Type of loan instrument and loan characteristics;
- Occupancy status; and, most important,
- Relative price appreciation on the underlying collateral for loans insured, usually associated with the relative age of the loan portfolio.

Geographic location

Location of property is a particularly important element. Local economic conditions affect the probability of default of an individual loan more than the national economy does. Consequently, the greater the geographic distribution of a firm's risk exposure, the less chance there is that purely random local economic dislocations will greatly affect its performance.

Perfect geographic distribution (with all other things being equal) would imply a distribution in proportion to the observed distribution of all private residences. However, localities are not equal in their vulnerability to economic dislocation. Default statistics by state indicate that some states have had consistently higher default rates, and others have had consistently lower ones. However, very few states are prolonged good or bad performers. A firm's performance could be improved if it concentrated in areas which exhibit greater economic diversification. Such diversification reduces an area's vulnerability to swings in the business cycle of individual industries.

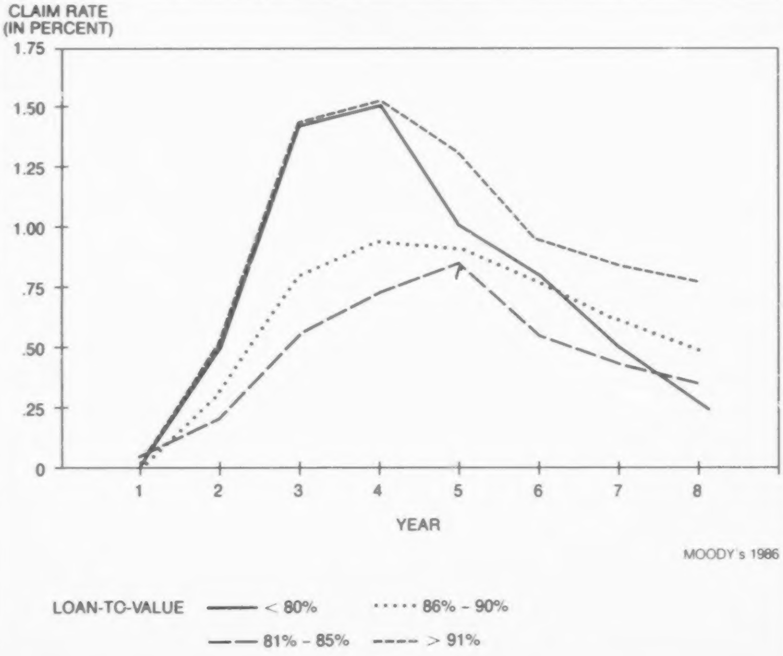
The mortgage insurance industry pattern has been to follow expanding local market areas, because lower default rates are often associated with economic expansion, growing land values and house prices. However, boom markets, like the Houston housing market in the late 1970s, sometimes fall upon hard times. Thus, the traditional method of managing risk, of spreading out risk exposure as best one can, remains the optimal long-run strategy. (See Table 3 for state performance during 1980-1985.)

Loan-to-value and net equity

Original loan-to-value has been a particularly sensitive measure of relative risk because it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan. The higher the

GRAPH 2

EVER TO DATE CLAIM RATES
ALL LOAN TYPES
1978-1985



MOODY's 1986

TABLE 2

Moody's Depression Scenario Assumptions for the U.S. Economy

Scenario Year	Home Price Change	Rate of Unemployment	Long-term Interest Rates	30-Day Cost of Money
1	0.00%	12.00%	10.00%	8.00%
2	−10.00	14.00	8.50	7.00
3	−10.00	20.00	7.50	6.00
4	−10.00	25.00	6.25	4.00
5	−10.00	22.00	5.00	3.00
6	0.00	20.00	5.00	3.00
7	1.50	18.00	5.00	3.00
8	3.00	16.00	6.00	4.00
9	3.00	14.00	6.00	4.00
10	3.00%	12.00%	7.00%	5.00%

TABLE 2A

Geographic Distribution of Primary Direct Risk in Force Comparisons By Regions and Ten Largest States, as of December 31, 1985

	UGRIC		GEMICO (OH)		MGIC (new)		PMI		VEREX		WMAC (old MGIC)		Foremost		Industry Averages	
	State	%	State	%	State	%	State	%	State	%	State	%	State	%	State	%
	CA	19.3	CA	11.7	CA	7.6	CA	25.0	CA	12.2	CA	12.5	CA	18.2	CA	15.3
	TX	9.6	FL	10.7	TX	6.8	TX	15.1	FL	8.2	TX	11.6	NY	12.4	TX	10.7
	FL	8.7	TX	9.7	OH	6.8	WA	7.5	TX	7.4	FL	6.0	NC	9.9	FL	7.3
	NY	3.5	AZ	5.1	MA	5.5	FL	5.1	NY	6.1	MI	4.2	MI	8.1	VA	3.6
	SC	3.5	OH	5.1	MI	5.0	CO	4.0	IL	3.8	IL	3.4	TX	7.0	IL	3.1
	LA	3.2	VA	4.9	WI	4.5	MD	3.8	PA	3.8	OH	3.3	PA	5.1	NY	3.0
	VA	3.0	NC	4.4	IL	4.0	IL	3.6	NJ	3.7	KS	3.0	NJ	5.1	MD	2.9
	NC	2.6	GA	4.0	NJ	3.8	GA	3.2	KS	3.6	MD	3.0	GA	5.0	OH	2.8
	OH	2.6	MA	3.7	FL	3.3	NC	3.0	MN	3.4	PA	2.8	FL	5.0	PA	2.8
	WA	2.6	MD	3.2	MO	3.3	VA	2.9	OK	3.0	NJ	2.8	MN	4.9	NC	2.7
Ten State Totals		58.6		62.7		50.6		73.2		55.1		52.6		80.7		54.2
By Region																
North East		9.9		11.0		21.5		8.3		17.1		14.3		25.7		13.3
N. Central		15.3		19.5		32.4		12.6		22.0		24.9		19.2		19.0
South		37.8		47.9		30.5		37.6		38.5		37.6		30.0		41.2
West		35.3		21.6		15.6		41.3		22.0		22.7		25.1		26.1
U.S. Territory		1.7		0.0		0.0		0.0		0.4		0.5		0.0		0.4
Non-U.S.		0.0		0.0		0.0		0.0		0.0		0.0		0.0		0.0
Total		100.0		100.0		100.0		100.0		100.0		100.0		100.0		100.0

	TMIC		CMAC (consol.)		GEMICO (NC, CA, FL)		HOME		IMI		Integon		RMIC		Industry Averages	
	State	%	State	%	State	%	State	%	State	%	State	%	State	%	State	%
	CA	21.1	CA	16.3	NC	13.5	VA	57.6	CA	29.4	GA	38.5	NC	19.0	CA	15.3
	TX	16.9	PA	11.3	TX	8.5	MD	10.9	NY	5.9	TX	17.9	FL	12.8	TX	10.7
	FL	8.8	TX	11.1	CA	8.0	PA	9.1	CO	5.7	FL	12.4	TX	10.2	FL	7.3
	VA	7.1	FL	10.2	FL	8.0	FL	7.4	WA	5.3	PA	5.3	GA	6.8	VA	3.6
	MD	5.4	NJ	9.8	LA	4.6	TX	5.8	FL	5.2	TN	3.2	VA	6.3	IL	3.1
	CO	3.3	GA	7.7	GA	4.4	NC	2.3	OH	4.4	VA	2.8	SC	6.0	NY	3.0
	MA	3.1	VA	6.8	VA	4.1	TN	1.9	TX	4.4	NC	2.5	CA	5.4	MD	2.9
	GA	3.1	MA	5.8	OK	3.5	DC	1.6	IL	3.5	SC	2.2	MD	4.8	OH	2.8
	IL	3.0	MD	5.5	MD	3.4	DE	0.7	MA	3.1	KY	1.7	AL	4.6	PA	2.8
	OH	2.3	TN	3.1	PA	3.3	SC	0.5	OK	2.8	IL	1.5	MO	4.0	NC	2.7
Ten State Totals		74.2		87.7		61.3		97.9		69.7		88.0		80.1		54.2
By Region																
North East		8.3		28.6		4.5		9.7		16.7		7.9		2.1		13.3
N. Central		12.2		1.3		16.3		0.3		13.5		4.3		8.9		19.0
South		47.8		51.2		63.4		89.6		23.4		85.4		79.3		41.2
West		31.8		18.9		15.8		0.5		46.3		2.5		9.7		26.1
U.S. Territory		0.0		0.0		0.0		0.0		0.1		0.0		0.0		0.4
Non-U.S.		0.0		0.0		0.0		0.0		0.0		0.0		0.0		0.0
Total		100.0		100.0		100.0		100.0		100.0		100.0		100.0		100.0

down payment, the less the likelihood is that the borrower will walk away from the loan. In order to examine the relative risk of loans by original loan-to-value and compare the experience of firms over time and under various economic situations, Moody's has requested and received claims-survivorship data by loan type, loan-to-value, occupancy status and year of origination from the nine largest firms in the industry. Three firms currently account for more than 90 percent of private mortgage insurance in force.

Based on ever-to-date claim rates for combined company data sets, the graphs presented reflect the general experience of the MI industry on more than 11 million loans classified by loan-to-value. The graphs have been separated into two multiyear groups of books of business: loans insured between 1957 and 1977 and loans insured between 1978 and 1985. The data represent the weighted average claim termination frequencies by policy year. For example, the first-year claim frequency equals the number of all first-year claims divided by the total number of originations, while for each successive year, claim frequencies are derived by dividing the number of all claims that year by the total number of loans outstanding at the beginning of the policy year.

These graphics are intended to show the impact of net equity on claim termination frequencies. In both sets of graphics, claim frequencies tend to get smaller as the loans grow older. This is generally associated with the growth in the net equity position of the loans. Net equity is defined as the market value of the home less the outstanding balance of the loan, interest due and the transaction costs of selling the property. While loan balances are paid down over time, early principal payments are quite small for several years. Consequently, most of the early growth in net equity is due to market value appreciation.

Net equity position, over time, has been established as the key determinant of default probability by several studies of Federal Housing Administration (FHA) data and has been confirmed for conventional loans by other researchers using loan data from MGIC. Moody's has reaffirmed these conclusions using its own model of default probability, based on a larger data

Table 3

Direct Losses Paid as a Percent of Previous End-of-Year Risk by State and U.S. Territory

State	1980	1981	1982	1983	1984	1985	1980-1985 Weighted Averages
Alabama	0.19%	0.26%	0.38%	0.77%	0.56%	0.79%	0.55%
Alaska	0.36%	0.18%	0.02%	0.04%	0.16%	0.78%	0.31%
Arizona	0.04%	0.23%	0.43%	1.04%	1.37%	1.12%	0.84%
Arkansas	0.11%	0.17%	0.26%	0.39%	0.41%	0.58%	0.36%
California	0.04%	0.20%	0.59%	1.36%	1.40%	1.07%	0.97%
Colorado	0.06%	0.16%	0.27%	0.86%	1.11%	1.87%	0.99%
Connecticut	0.11%	0.26%	0.43%	0.56%	0.31%	0.14%	0.28%
Delaware	0.24%	0.23%	0.28%	0.20%	0.24%	0.26%	0.24%
Wash., D.C.	0.21%	0.10%	0.21%	0.44%	0.33%	0.27%	0.27%
Florida	0.08%	0.10%	0.36%	1.05%	1.66%	1.42%	1.07%
Georgia	0.14%	0.18%	0.36%	0.42%	0.34%	0.34%	0.31%
Hawaii	-0.00%	0.06%	0.31%	0.85%	1.21%	1.35%	0.74%
Idaho	0.10%	0.24%	0.47%	0.87%	0.86%	0.80%	0.59%
Illinois	0.22%	0.47%	0.75%	1.15%	1.19%	1.12%	0.88%
Indiana	0.25%	0.44%	0.84%	1.15%	1.07%	1.07%	0.84%
Iowa	0.34%	0.64%	1.31%	1.80%	1.67%	1.46%	1.27%
Kansas	0.25%	0.36%	0.55%	1.06%	1.20%	1.13%	0.88%
Kentucky	0.27%	0.47%	0.58%	0.82%	0.65%	0.80%	0.64%
Louisiana	0.04%	0.08%	0.11%	0.36%	0.73%	1.13%	0.54%
Maine	0.46%	0.64%	0.75%	0.84%	0.48%	0.28%	0.53%
Maryland	0.19%	0.16%	0.25%	0.31%	0.33%	0.44%	0.31%
Massachusetts	0.16%	0.12%	0.23%	0.20%	0.06%	0.08%	0.12%
Michigan	0.12%	0.34%	0.77%	1.64%	1.27%	0.79%	0.84%
Minnesota	0.06%	0.11%	0.24%	0.48%	0.68%	0.83%	0.51%
Mississippi	0.13%	0.26%	0.50%	0.69%	0.75%	2.22%	0.88%
Missouri	0.37%	0.53%	0.95%	1.11%	0.74%	0.59%	0.70%
Montana	0.17%	0.59%	1.24%	1.14%	1.21%	1.10%	0.92%
Nebraska	0.24%	0.42%	0.94%	1.44%	1.28%	1.32%	1.00%
Nevada	0.05%	0.19%	0.67%	1.11%	1.81%	2.23%	1.27%
New Hampshire	0.13%	0.21%	0.45%	0.46%	0.28%	0.06%	0.24%
New Jersey	0.17%	0.18%	0.25%	0.87%	0.54%	0.89%	0.61%
New Mexico	0.04%	0.05%	0.15%	0.34%	0.55%	0.51%	0.34%
New York	0.67%	0.45%	0.40%	0.35%	0.19%	0.18%	0.29%
North Carolina	0.18%	0.20%	0.35%	0.41%	0.43%	0.27%	0.31%
North Dakota	1.07%	1.09%	1.91%	2.49%	2.78%	2.44%	2.02%
Ohio	0.45%	0.71%	1.35%	1.80%	1.42%	1.01%	1.14%
Oklahoma	0.20%	0.22%	0.18%	0.55%	1.00%	1.99%	0.92%
Oregon	0.11%	0.26%	0.93%	2.66%	2.20%	2.55%	1.54%
Pennsylvania	0.42%	0.46%	0.69%	0.81%	0.54%	0.60%	0.58%
Rhode Island	0.36%	0.47%	0.85%	0.49%	0.30%	0.26%	0.42%
South Carolina	0.13%	0.18%	0.37%	0.41%	0.35%	0.52%	0.37%
South Dakota	0.43%	0.84%	1.55%	1.11%	1.50%	1.52%	1.20%
Tennessee	0.16%	0.35%	0.71%	0.84%	0.59%	0.76%	0.59%
Texas	0.10%	0.14%	0.26%	0.74%	1.21%	2.31%	1.07%
Utah	0.20%	0.69%	1.41%	1.14%	1.74%	1.83%	1.36%
Vermont	0.05%	0.25%	0.31%	0.80%	0.55%	0.42%	0.45%
Virginia	0.13%	0.18%	0.31%	0.30%	0.45%	0.49%	0.35%
Washington	0.05%	0.14%	0.55%	1.14%	1.60%	1.36%	0.98%
West Virginia	0.27%	0.62%	0.79%	1.29%	1.31%	1.15%	1.00%
Wisconsin	0.25%	0.56%	1.07%	1.46%	1.24%	1.18%	1.02%
Wyoming	0.05%	0.18%	0.32%	2.07%	4.23%	6.06%	2.71%
Guam	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Puerto Rico	1.60%	1.23%	0.86%	0.76%	0.53%	0.58%	0.91%
Virgin Islands	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	0.18%	0.28%	0.50%	0.90%	1.01%	1.12%	0.78%

Notes 1 Data exclude losses paid and risk in force of US Mortgage Insurance Company for all the above years. Investors Mortgage Insurance for years 1980 to 1984 and Republic Mortgage Insurance Company for 1985

2 Ratios were calculated as direct losses paid as a percent of the previous end-of-year direct risk in force

3 1980-1985 weighted averages represent total direct losses paid over the period divided by the sum of each previous year's risk in force

base representing all of the MIs it reviews.

The separation of the graphs by two time periods is intended to show that the inflation-induced net equity positions of the 1970s were clearly responsible for keeping MI claim termination rates so low (see Graph 1). Claim frequencies generally peaked in the third policy year for all loan-to-value categories, falling off gradually as net equity improved through repayment of principal and, more importantly, through increased market value of the property.

In Graph 2, claim terminations were markedly higher over the 1978-1985 period. While record postwar unemployment rates in 1981 and 1982 certainly contributed to the high default rates in those years, the principal cause was the very low level of home price appreciation nationally and the actual decline in home prices in many areas of the country. These same areas have suffered unusually high levels of claim frequencies, even as the economy moves into its fourth year of economic recovery. Also note that claim frequencies have not peaked in the third policy year but have tended to peak in the fourth or fifth. Moreover, claim frequencies have not declined appreciably, because home price appreciation has remained low since 1981. Moody's analysis of the MI claim data suggests that if future home price appreciation remains as low as the National Association of Realtors projects during the next decade, relatively unseasoned loans as well as all new high loan-to-value loans insured will continue to incur high default rates during the next several years.

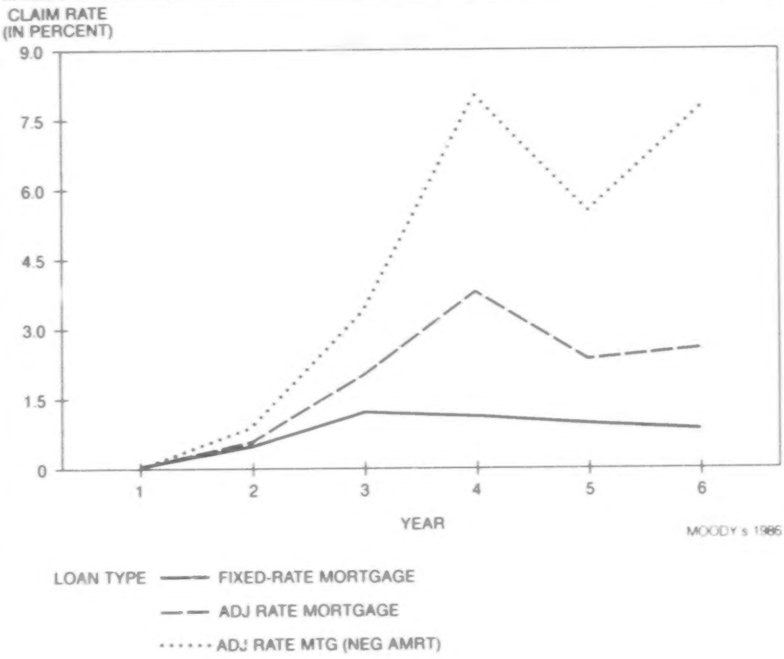
Occupancy status

Occupancy risk is another major category for differentiating risk. Vacation homes and investor homes, taken together, have had more than twice the frequency of default and markedly higher average claim amounts than owner-occupied home loans. Investors homes, alone, have proven to be more than four times as risky.

Investor loans account for a large percentage of privately insured less than 81 percent loan-to-value loans, ranging from 33 percent to 53 percent of such loans (except for new MGIC, whose new policy standards exclude investor loans). There are far fewer

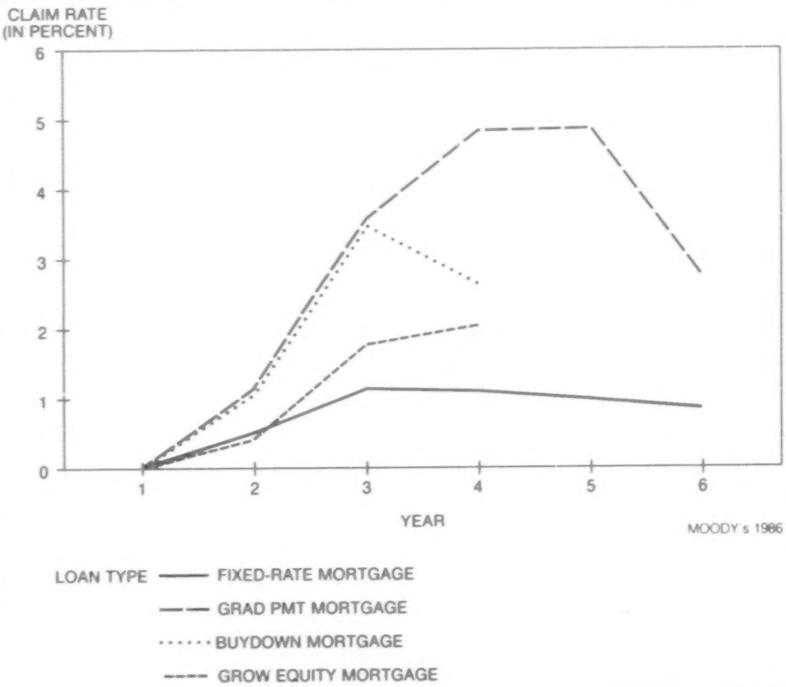
GRAPH 3

EVER TO DATE CLAIM RATES
LOAN TYPE COMPARISON
LOAN-TO-VALUE > 91%
1980-1985



GRAPH 4

EVER TO DATE CLAIM RATES
LOAN TYPE COMPARISON
LOAN-TO-VALUE > 91%
1980-1985



investor loans as the loan-to-value category gets higher. There is also a heavier concentration of such loans in ARMs, graduated payment mortgages (GPMs), and other alternative mortgage instruments designed to keep earlier year monthly payments lower than would be the case for fixed-rate, fixed-payment mortgages.

The adverse insured investor-loan experience suffered by the mortgage insurance companies, Fannie Mae and Freddie Mac has resulted in substantial underwriting changes with regard to such loans. Most firms will now only agree to 20 percent down loans, with closer screening of information and substantially higher insurance premiums. Before long, insured investor loans may become a thing of the past. They are not a large portion of any mortgage insurance portfolio, running from 3 percent to about 10 percent of total risk exposure on the individual companies, and about 7 percent of the industry's total risk exposure.

Risk by loan instrument

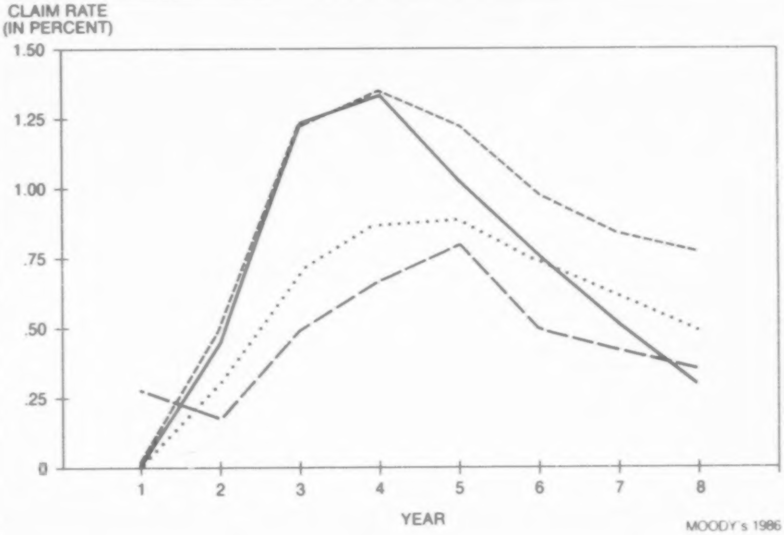
The claim frequencies presented in Graph 2 were greatly affected by the experience of new types of mortgage instruments insured by the industry whose full risk potential was unknown at the time of their introduction. Development of new types of loan instruments has introduced new elements of risk, some aspects of which are speculative in nature and cannot be actuarially defined. These instruments were originally designed to address the issue of housing affordability. By 1979, high interest rates and continued home price inflation had made homeownership difficult for many first-time homeowners. Adjustable rate mortgages were later introduced, not only to reduce early year interest costs, but also to provide intermediaries with a reduction in interest rate risk.

Differences in loan types affect both the borrower's equity position and his ability to make payments. Payments on normal, fixed-rate conventional loans are level, with speed of principal repayment determined by the coupon rate and the term to maturity. As long as a homeowner maintains employment and incurs no additional debt, his ability to meet monthly payments will not likely be affected. Many of the new loan instruments involve scheduled or potential changes in monthly payments. Such loan instruments assume that a borrower's income will increase over time at some minimum growth rate to meet the planned or unplanned adjustments to monthly payments.

Examples of the various loan types and their effect on payments and net equity vary considerably. Most graduated payment mortgages have fixed interest rates but schedule payment increases, as well as planned limited negative amortization, in the early years of the mortgage. Growing equity mortgages (GEMs) have no negative amortization but do have scheduled payment increases, which rapidly increase the borrower's equity position.

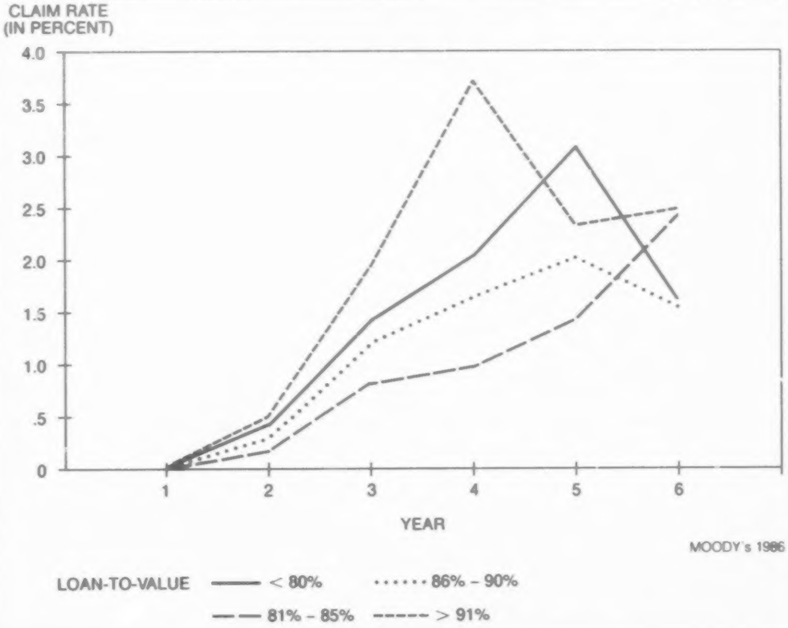
GRAPH 5

EVER TO DATE CLAIM RATES
FIXED-RATE MORTGAGES
1978-1985



GRAPH 6

EVER TO DATE CLAIM RATES
ADJUSTABLE RATE MORTGAGES
1980-1985



Builder buydowns were introduced to reduce monthly payments in the early years of loans. Depending upon the size of the buydown, monthly payments increase to full regular payments within one to three years. Quite often, the cost of buydowns is recaptured in the price of the home, distorting the true initial loan-to-value ratio.

ARMs potentially can include all of these characteristics, depending on what loan features have been adopted for a particular loan. The variety of features in ARMs makes this particular instrument difficult to assess and to track over time. However, there has been a marked trend toward greater standardization in ARM instruments, which will improve Moody's ability to assess the risk exposure presented to mortgage insurers.

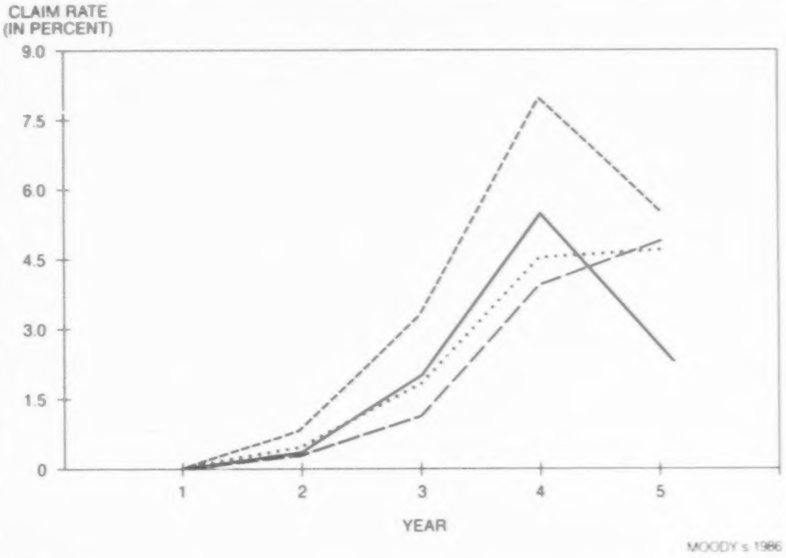
In the graphics, the claim termination rates of fixed-rate, fixed-payment mortgages (FRM) are compared with sets of claim rates of non-conventional loan types for the 91 percent to 95 percent loan-to-value group. Except where noted, the claim experience is for loans originated between 1980 and 1985. Data for 1985, for the sixth policy year, should be considered preliminary, because only the largest companies had reported 1985 claims-survivorship results at the time this article was prepared. However, given the relative market share of these companies and the number of loans represented, the sixth-year results presented should be considered to have only a very small degree of potential error. Moody's will provide fully updated figures in a future report on the industry.

In Graph 3, the 1980-1985 default experience of 5 percent down, fixed-rate, fixed-payment loans is compared with fully amortizing adjustable rate mortgages that permit or schedule negative amortization. Compared with fixed-rate, fixed-payment mortgages, fully amortizing ARMs were more than twice as likely to default, with 5 percent down ARMs that permit negative amortization were 4.8 times as likely to default. More important, these differences arose over a period—especially in policy years three through six—when interest rates were falling. Should such loans be faced with a period of rising interest rates, the additional payment shock and the squeeze on net equity permitted by negative-amortizing ARMs could push claim rates on such mortgage instruments to even higher levels.

Graph 4 compares fixed-rate, fixed-payment mortgages with graduated payment mortgages, growing equity mortgages and mortgages with temporary buydowns. The experience for both buydowns and GEMs is limited, however, both instruments display claim frequencies that are higher than fixed-rate mortgages and can only be attributed to payment shock. What is quite surprising is that the buydowns very nearly approximate GPM experi-

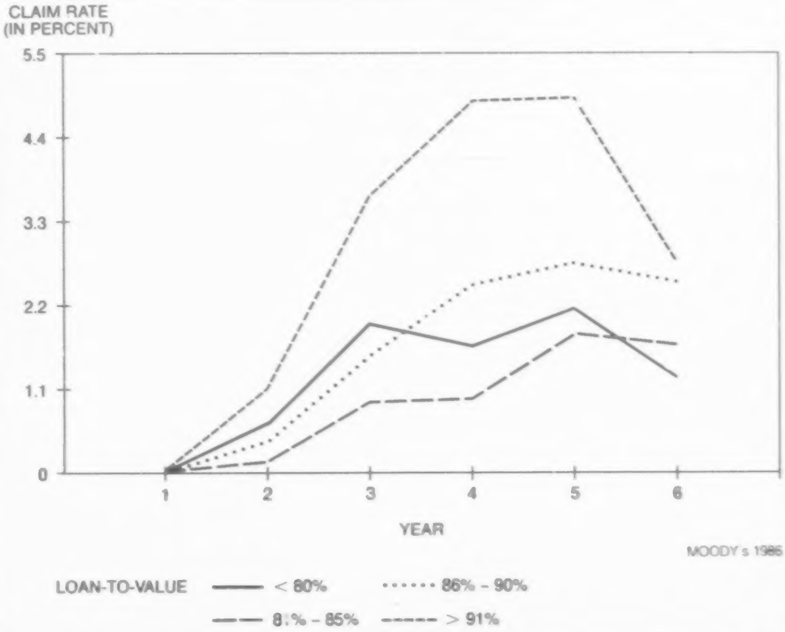
GRAPH 7

EVER TO DATE CLAIM RATES
NEGATIVE AMRT MORTGAGES
1981-1985



GRAPH 8

EVER TO DATE CLAIM RATES
GRADUATED PMT MORTGAGES
1980-1985



ence for the first three policy years. Because buydown loans are often offered through builders, there is strong suspicion that the property value may include the cost of the buydown arrangement, reducing real net equity.

The sharp drop in buydown instruments during the fourth policy year can be attributed to the fact that most of these instruments are limited to buydowns of up to three years. Therefore, most of the buydowns have reached level payment status by the fourth year. Graduated payment mortgages present not only payment shock, but also built-in negative amortization for the first several years of the loan. Most of the insured GPMs reached level payment status by the sixth or seventh year, and this explains the drop in claim frequency at that time.

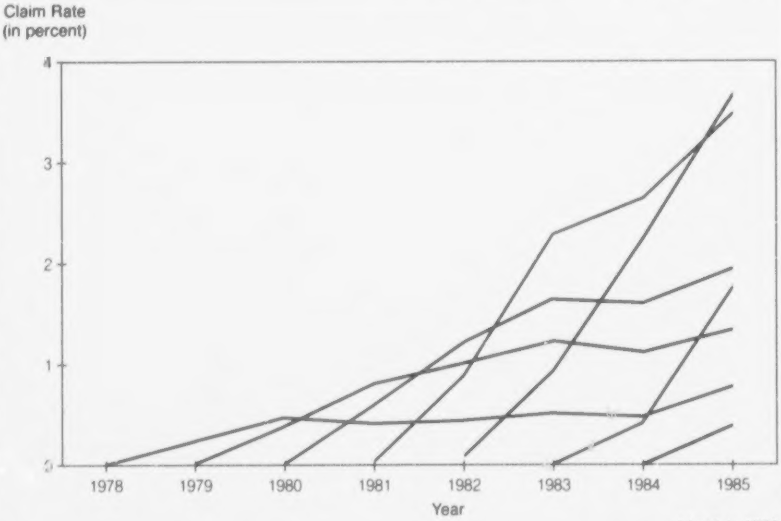
The remaining charts depict claim frequencies by four loan-to-value groupings in four major loan types during the past six to eight years, depending on the instrument type. Note the differences in claim-rate scale between loan types when making comparisons. Graph 5 depicts claim frequencies for fixed-rate, fixed-payment mortgages for 1978-1985. While the frequencies are generally lower than those depicted for all loans originated between 1978 and 1985, the shapes of curves are very close. Claim frequencies for later policy years are nearly equal because of the dominance of fixed-rate loans originated before 1982.

Graph 6 depicts claim rates on fully amortizing, adjustable rate mortgages. Compared with fixed-rate mortgages, the claim frequencies for all loan-to-value categories are higher. Also note that the claim frequencies jumped back up for most of the loan-to-value groups in the sixth policy year. Moody's attributes this to both continued low home price appreciation and heavier prepayments of loans in 1984, which contributed to adverse selection on the remaining book.

Graph 7 depicts claim frequencies on ARMs with potential or scheduled negative amortization. All loan-to-value groups show claim frequencies higher than fully amortizing ARMs. These loans have peaked in the fourth year on average. However, given the preponderance of 1981, 1982 and 1983 negative-amortization ARMs and the fact that foreclosure frequencies of loans originated in these years have yet to turn downward, there is the possibility that the average peak claim frequency on negative-amortizing ARMs may be longer than four years.

GRAPH 9

Claim Rates
Fixed-Rate Loans
Loan-to-Value > 91%
1978–1985



Moody's 1986

Claim rates on graduated payment mortgages by loan-to-value groups are depicted in Graph 8. Nearly all of the loan-to-value groups display a peak claim rate in the fifth policy year reflecting a relationship to the maximum number of scheduled payment increases and the degree of added negative amortization.

The final chart is intended to express Moody's concerns over the combined impact of continued low home price appreciation in many areas of the country and the recent decline in mortgage interest rates on refinancing and adverse selection. Mortgage interest rates have been declining steadily since 1983, while home price appreciation has remained extremely weak. Moreover, through the first half of 1986, mortgage interest rates have experienced the sharpest drop of the postwar era. Refinancing generally occurs if the drop in the mortgage market coupon falls sufficiently to cover the expense of refinancing over a period of three to seven years, depending upon the residency plans of the borrower. If there has been sufficient property appreciation, a loan previously requiring private insurance may no longer require insurance on the refinancing, leading to additional savings for the borrower.

Therefore, those areas of the country that have had greater than average price appreciation are also most likely to refinance and go off the books, leaving the MIs with higher risk loans. As a consequence of this adverse selection process, claim frequencies on seasoned portfolios should tend to rise. Graph 9 shows just such a trend. Using five percent down, conventional fixed-rate mortgages, the chart depicts claim frequencies over time for such loans grouped by year of origination. For all of the groups of loans originated during 1978-1980, claim frequencies peaked in 1983, declined in 1984, and then reached new peaks in 1985. All of the books from 1981 forward have yet to turn down. Alarmingly, the claim frequencies for both the 1981 and 1982 books of business worsened sharply in 1985 from 1984, because of the dual influence of refinancing and low price appreciation. The 1983 book, while better than 1981 and 1982, remains worse than the 1980 book. The 1984 book so far appears to resemble the 1979 book. The 1985 book, because of tighter underwriting standards, has had the best first-year performance in more than 14 years. ☐

MORTGAGE MARKET TRENDS

With data for December just starting to be made available, it appears that the annual rate of GNP growth for the fourth quarter might still come in at 3 percent or a little more. This would be only a modest increase from the third quarter pace of 2.8 percent, and is probably higher than we can expect for the first half of 1987. A portion of the fourth quarter's activity was driven by changes to the tax code that went into effect at year-end. This boost provided to fourth quarter output will weaken demand in 1987, especially in the early months of the year. Thus, there should be little if any upward pressure on interest rates through the middle of the year, and there is still a likelihood of another cut in the discount rate by mid-year.

Despite the fact that gains in the disposable personal income of consumers slowed in November, spending picked up modestly after a slip in October. Excluding autos, retail sales in November showed a rebound from October's sales pace. Auto sales slid further in November, but soared in December to their highest rate for that month since 1976. Even with the year-end surge, domestic auto sales in the fourth quarter will be below the financing-induced sales pace of the autumn months. This flurry of last-minute spending will, however, leave consumers with further reductions in their savings, and thus restrict their ability to increase their level of expenditures in the coming months of 1987.

Industrial production, following only slight growth in October, rose fairly strongly in November. Increases were widespread among the major categories of manufacturing output. New orders for durable goods excluding defense rose modestly further in November to a level above third quarter averages.

Although business fixed investment may post a modest fourth quarter increase, the outlook for further gains in this sector during 1987 is not good. Orders for non-defense capital goods rose by 6.4 percent in November, and this measure is currently running at a fourth quarter pace 1½ to 2 percent above the third quarter's. December's investment levels could be heavily affected by the change in year-end depreciation schedules, but with capacity utilization still below 80 percent in November, continued improvement into 1987 appears unlikely. In fact, the latest Commerce Department estimate now predicts a slight 0.2 percent increase in real spending by business for new plant and equipment in 1987 relative to 1986. Further, although construction of non-residential buildings remained at a relatively healthy pace in the fourth quarter, the negative impact of the new tax changes, plus the high current level of vacancy rates for commercial property, are expected to reduce activity in this sector of the economy during 1987.

Activity in the residential housing market, while off a bit from earlier levels, remains relatively healthy. Sales of existing homes reached an annual rate of 3.92 million units in November, the highest level since September 1979. New one-family home sales dipped in November, but single-unit housing starts nevertheless rose somewhat from October's level. Starts of multifamily structures, however, declined 5 percent in November, even as permits for further construction jumped 15 percent. This large jump in multifamily permits is probably only a reflection of stricter limits imposed by the new tax law on industrial development bond financing of multifamily construction. Thus, even with a continuation of the current mortgage rate climate, residential investment probably will not be a source of stimulus to economic activity in 1987.

Two important elements of the economic climate during 1987 will be affected by yet a third. Recent data on prices and wages have continued to be encouraging, which in turn have benefited interest rates. The decline in the value of the dollar, relative to foreign currencies, has yet to have a material impact on domestic prices. Increases in producer prices remained small in October and November, and actually registered no change in December. Consumer prices have risen moderately in recent months. However, at least a portion of this moderation in prices can be expected to dissipate if the newfound discipline among OPEC members is more than just a temporary phenomenon.

A surge in the U.S. trade deficit occurred in November, and the estimated deficit for October was revised upward. While the monthly trade figures can be quite erratic and subject to substantial revision, the November data were indeed unexpected, as many observers had thought that improvement was underway during the summer months. Nevertheless, some improvement in this sector is still expected during 1987.

With the economy likely to grow moderately in the first half of the year, the Fed may decide to take further easing actions early this year in the form of a cut in the discount rate. Recent developments, however, may have reduced somewhat the probability of additional aggressive moves towards ease by the Fed. The dollar has come under renewed downward pressure in international markets, and the Federal Reserve may be reluctant to put greater pressure on the dollar by lowering domestic interest rates. Also, the recent increase in world oil prices, together with the growing threat of protectionist measures, may add somewhat to inflationary pressures in 1987.

On balance, MBA economists think that modest further declines in interest rates are probable, including a reduction in conventional mortgage rates to a little below 9 percent by mid-year. A decline of this magnitude should allow single-family housing starts during 1987 to average around their current level of 1.2 million units, with the volume of mortgage originations remaining close to levels in the latter months of 1986.

Gregory D. Luetscher
Economist
January 12, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JUN	184	132	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	164	117	47	1,795	1,275	520	144	100	44	1,673	1,147	526
SEP	154	108	46	1,664	1,161	503	152	103	49	1,603	1,144	459
OCT	155	109	46	1,628	1,171	457	145	103	43	1,565	1,109	456
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
11 MONTHS												
1986	1,693	1,185	508				1,624	1,101	523			
1985	1,621	1,094	527				1,606	1,010	596			
1984	1,616	1,093	523				1,575	1,005	570			
1983	1,595	1,112	483				1,497	970	527			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JUN	30	35	70	48	283	300	768	501	28	30	66	50	274	286	728	504
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	692	457
AUG	34	30	60	40	321	293	707	474	25	28	52	39	272	289	653	459
SEP	29	27	61	37	280	270	702	412	30	28	53	41	297	258	597	451
OCT	27	28	60	41	250	238	678	462	27	27	52	40	260	249	598	458
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
11 MONTHS																
1986	275	276	693	449					264	272	634	454				
1985	235	227	726	435					242	220	690	453				
1984	190	232	815	413					186	200	760	430				
1983	159	207	873	357					153	179	806	360				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
JUN	338	66	340	5.8	226.7	102.4	32.8	91.5	1,153	665	488	150	103	47
JUL	336	57	349	6.1	229.2	104.1	32.5	92.6	1,157	675	482	151	101	50
AUG	341	52	354	7.0	232.2	105.4	32.4	94.4	1,164	682	482	159	109	50
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	677	476	157	112	45
OCT	326	54	362	6.4	231.6	106.8	32.7	92.1	1,143	675	468	167	117	50
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
11 MONTHS														
1986	3,299	698										1,580	1,086	494
1985	3,099	639										1,536	1,054	482
1984	2,694	601										1,503	1,034	469
1983	2,539	574										1,252	913	339

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
6 MONTHS										
1986	239,773	57,049	90,581	77,779	14,364	177,399	52,855	73,356	49,840	1,348
1985	154,435	27,409	64,260	51,319	10,477	101,481	25,544	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,578	489	1,363	508	218	9,420	224	1,474	5,480	2,242
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
6 MONTHS										
1986	13,009	2,676	7,843	2,975	1,515	49,365	1,518	9,382	26,964	11,501
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	$26,031	$7,695	$12,913	$3,000	$2,423	$ 96,650	$13,930	$47,353	$18,327	$17,040
FEB	31,132	7,954	13,907	6,680	2,591	108,898	16,153	44,355	30,732	17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,521	24,409	56,406	56,531	23,175
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
6 MONTHS										
1986	259,843	65,568	112,989	59,193	22,093					
1985	144,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,878	64	3,971	27	1,942	62	4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
11 MONTHS												
1986	3,068	1,797	413	858	n.a.	n.a.	n.a.	n.a.	306	21,952	537	42,125
1985	2,031	822	229	980	1,168	76,986	315	18,425	173	11,699	680	46,862
1984	1,736	427	182	1,127	1,262	82,462	190	10,260	185	12,730	887	59,472
1983	1,830	721	314	795	1,198	71,876	356	18,093	263	16,518	579	37,265

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL	3,270	3,343	76,197	6,106	8,585	7,863	8,518	8,118	14,246	10,226
AUG	3,840	3,800	81,060	7,079	12,722	13,707	10,458	10,127	10,177	6,813
SEP	4,248	4,649	86,359	7,357	10,943	10,658	12,485	13,090	36,333	12,861
OCT	2,375	3,784	89,573	5,535	n.a.	n.a.	n.a.	n.a.	9,859	10,221
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1985 TOTAL	20,225	21,510	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
1984 TOTAL	21,007	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
11 MONTHS										
1986	31,716	28,491	—	55,073	89,264	81,524	70,740	68,911	142,534	86,046
1985	18,367	19,848	—	20,284	31,446	34,488	31,021	28,589	58,932	41,349
1984	18,249	14,759	—	12,254	20,359	21,606	12,642	11,590	32,849	25,787
1983	17,136	15,354	—	12,500	24,997	26,452	17,043	15,674	66,234	47,953

* FHLMC Year-to-date totals are for nine months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
JUL	10.01%	10.28%	10.32%	10.30%	10.26%	8.29%	9.813%	12.02%
AUG	9.80	9.88	9.92	10.26	10.26	7.96	9.455	11.45
SEP	9.90	9.96	9.95	10.17	10.08	7.86	9.588	12.16
OCT	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
NOV	9.26	9.47	9.47	9.91	9.84	7.76	9.440	11.54
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
JUL	9.32%	9.48%	9.49%	9.57%	7.30%	5.86%	6.33%
AUG	9.11	9.20	9.23	9.51	7.17	5.55	5.92
SEP	9.28	9.25	9.30	9.56	7.45	5.35	5.68
OCT	9.05	9.12	9.16	9.48	7.43	5.26	5.68
NOV	8.78	8.91	8.94	9.31	7.25	5.42	5.76
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
JUL	50	202	218	219
AUG	29	194	203	206
SEP	34	183	180	185
OCT	49	162	169	173
NOV	18	153	166	169
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

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MORTGAGE BANKING

MARCH 1987

EMICs

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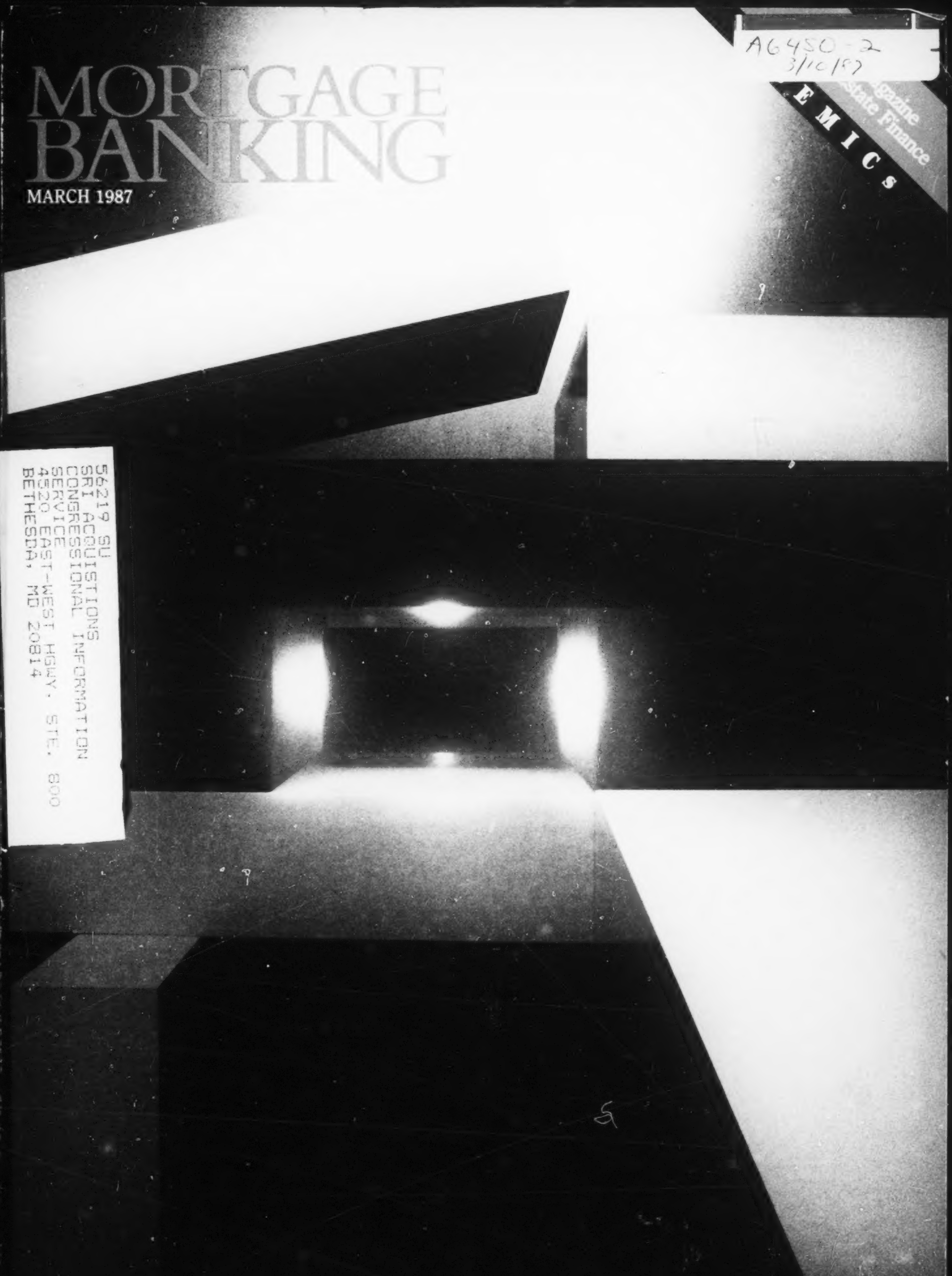
State Finance



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MORTGAGE BANKING

VOLUME 47 NO. 4
MARCH 1987

ARTICLES

PAGE 8
CAPITAL PREVIEW: GOING PUBLIC OR PRIVATE
Scott A. Shay
Mortgage banking is a capital intensive business today. Competitors that acquire sufficient capital from financially set parent companies or from public markets will take away market share from those without adequate capital. This Salomon Brothers' expert details ways in which a mortgage company can raise needed capital.

PAGE 24
WHAT DO REMICs MEAN TO YOU? UNDERSTANDING THE BUILDING BLOCKS
Donald B. Susswein
This article describes what REMICs are and how they will change mortgage-backed securities transactions. Several examples illustrate the author's explanations. You will need to know the building blocks to understand what REMICs will mean to the industry.

PAGE 35
HEDGING WITH FUTURES: NAVIGATING THE RAPIDS
Mark Pitts, Kay Willcox and Hasan Latif
Shearson Lehman Brothers presents its approach to hedging MBSs that models the prepayment option attached to mortgage loans.

PAGE 49
EXCESS SERVICING: THE RISKS AND THE REWARDS
Jonathan M. Prince and Val R. Bitton, CPA
Learn why lenders would sell lower pass-through rates to the secondary market and how lenders will account for such transactions in this article. The economics and accounting treatment for excess servicing are examined closely.

PAGE 62
CUSTOMIZED MORTGAGES: MORE THAN JUST PLAIN VANILLA
H. Beth Marcus
Today there are a variety of mortgage products available that cater to the differing tastes and needs of the consumer. The day may not be far away when a borrower will go to a lender and ask for a loan that meets exact requirements—payments, interest, rate of equity build-up and mortgage term, according to this author.

PAGE 75
FLOW SERVICING SALES: WHAT ARE THE ADVANTAGES?
Kenneth Cohen
This article explores the salient characteristics of flow servicing transactions, involving both government and conventional loans. Monthly sales of flow transactions offer significant advantages to both parties.

PAGE 85
SECONDARY MORTGAGE MARKET IN THE LAND DOWN UNDER
Prue Larocca
This articles describes the emerging secondary market in Australia. Interestingly enough, the Australian secondary market is sponsored by state governments rather than the federal government. Plans are underway to make the Australian secondary market similar to the U.S. secondary mortgage market.

PAGE 95
BUSINESS BASICS HOW TO HEDGE YOUR MORTGAGE PIPELINE
Calvin M. Watts
This article gives a basic description of different hedge strategies and identifies the risks involved.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 95
PEOPLE 102
BOOKS 112
SECONDARY MORTGAGE MARKETS 115
MORTGAGE MARKET TRENDS 117
AD INDEX 126

MORTGAGE MARKET TRENDS

Recent revisions in the 1986 November foreign trade figures should result in a revised figure for the fourth quarter's annualized growth rate of gross national product (GNP) of slightly more than 2 percent. A slowdown in the rate of growth of consumer spending, partially offset by increases in inventory investment and net exports, should lead to economic growth at a similar pace in the first half of 1987. Interest rates should remain at roughly current levels during this period, then trend upward somewhat in the second half of the year as the pace of economic activity improves moderately to the 3 percent range.

Early reports suggest that the economy is currently stronger than had been expected. Non-farm payroll employment registered a gain of 450,000 new jobs in January, compared with the monthly average of 260,000 of the fourth quarter. Even after taking into account that the January figure reflects some seasonal adjustment difficulties that magnify the gains in the construction and retail trade sectors, the increase was large enough to indicate that the economy started the new year with a good deal of momentum.

The rate of growth of consumer spending, which was 4 percent in 1986, should be somewhat weaker this year. In both 1985 and 1986, the rate of growth of personal consumption exceeded that of income by a significant amount. This resulted in rates of increase of consumer installment debt of 18 percent in 1985 and 11 percent in 1986, as well as a sharp decline in the personal saving rate. Consumers can now be expected to slow their consumption plans in order to pay down debt and replenish their savings. In addition, much of the spending initially planned for early 1987 was "moved up" to the second half of 1986 to take advantage of financing incentives and to avoid the loss of the sales tax deduction under the new tax law, which went into effect at the beginning of the year.

There are signs that the consumer is already retrenching. Real personal consumption expenditures declined in the fourth quarter. The rate of growth of installment credit fell to 0.2 percent in December. The Conference Board reports a sharp drop in consumer spending plans in January compared with December. Also, January 1987 automobile sales were extremely slow. However, the fact that major retail chains reported moderate sales growth in January indicates that the consumer spending might not be quite as weak as earlier anticipated.

Business investment in plant and equipment can be expected to remain relatively flat during the course of the year. Residential construction is expected to decline somewhat, with strength in the single-family sector being offset by further declines in the multifamily area, due largely to unfavorable changes in tax law and high vacancies.

There are indications that the recent strength in merchandise exports can be expected to intensify in the near term. The fall in the value of the dollar during the past two years finally seems to be taking effect on the export side. Anecdotal evidence indicates a substantial increase in business for firms engaged in the production of such exchange rate sensitive items as chemicals, drugs, lumber and paper products, computers and heavy machinery. This perception is reinforced by the recent strong performance of the securities of firms in these sectors on the stock market. In addition, the January Purchasing Managers Survey found that a significant portion of their observed increase in orders was attributed to export orders as well as to business that was switched to domestic suppliers.

The anticipated export gains should result in a steadily improving trade balance during the course of the year even though the volume of imports can also be expected to increase somewhat. This should add significant strength to the economy, especially in the second half.

Government spending is likely to show only sluggish growth in 1987 as the administration and Congress strive to comply with the spirit of Gramm-Rudman-Hollings.

Inflation is expected to return to its year-earlier level or somewhat higher now that the full effects of the fall in the price of oil have worked their way through the system. Indeed, oil prices have increased significantly during the past several months. In addition, increased prices for imported goods could lead to increases in some domestically produced goods as well. However, the rate of price increase should remain in the 3- to 4-percent range.

The unexpected strength in the current quarter implied by the recently released data sharply reduce the prospects of a lowering of the discount rate by the Federal Reserve in the near term. This is especially true in light of international monetary market considerations with respect to the dollar.

Continued moderate mortgage interest rates should result in another strong year in the single-family housing sector in 1987. Single-family starts should reach 1.25 million while origination volume approaches $350 million.

Victor Cholewicki
Economist
February 10, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	164	117	47	1,795	1,275	520	144	100	44	1,673	1,147	526
SEP	154	108	46	1,664	1,161	503	152	103	49	1,603	1,144	459
OCT	155	109	46	1,628	1,171	457	145	103	43	1,565	1,109	456
NOV	116	83	33	1,585	1,154	431	109	72	37	1,613	1,083	530
1986 TOTAL	1,807	1,263	544				1,759	1,183	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
12 MONTHS												
1986	1,807	1,263	544				1,759	1,183	576			
1985	1,742	1,166	576				1,734	1,077	657			
1984	1,750	1,206	544				1,682	1,065	617			
1983	1,703	1,181	522				1,605	1,035	570			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	691	457
AUG	34	30	60	40	321	293	707	474	25	28	52	39	272	289	653	459
SEP	29	27	61	37	280	270	702	412	30	28	53	41	297	258	597	451
OCT	27	27	60	40	256	236	682	454	27	27	52	40	260	249	598	458
NOV	22	20	43	31	272	244	591	478	19	21	41	29	260	287	605	461
1986 TOTAL	294	295	733	484					286	291	678	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
12 MONTHS																
1986	294	295	733	484					286	291	678	504				
1985	252	240	782	468					260	237	753	484				
1984	204	243	866	436					201	212	812	457				
1983	168	218	935	382					164	188	863	390				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
JUL	336	57	349	6.1	229.2	104.1	32.5	92.6	1,157	675	482	151	101	50
AUG	341	52	354	7.0	232.2	105.4	32.4	94.4	1,164	682	482	159	109	50
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	677	476	157	112	45
OCT	326	54	361	6.2	231.6	107.0	32.7	91.9	1,142	675	467	167	117	50
NOV	266	48	357	6.2	230.1	107.0	33.0	90.1	1,123	664	459	148	106	40
1986 TOTAL	3,565	749										1,755	1,205	550
1985 TOTAL	3,214	688										1,704	1,170	534
12 MONTHS														
1986	3,565	749										1,755	1,205	550
1985	3,214	688										1,704	1,170	534
1984	2,868	639										1,652	1,137	515
1983	2,719	623										1,390	1,016	374

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$28,203	$5,835	$10,478	$9,983	$1,907	$18,980	$5,326	$8,157	$5,418	$79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
JUN	59,859	14,251	21,960	20,140	3,508	45,093	12,963	18,460	13,465	205
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
7 MONTHS										
1986	302,492	73,583	112,268	98,724	17,917	224,749	68,715	91,995	62,200	1,839
1985	186,310	34,913	76,436	62,370	12,591	123,445	32,205	57,317	33,431	492
1984	175,871	33,330	77,815	55,992	8,734	123,189	31,187	59,205	32,322	475
1983	149,110	37,568	54,919	49,701	6,922	110,261	35,547	43,619	30.674	421

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$2,335	$323	$1,099	$541	$372	$6,888	$186	$1,222	$4,024	$1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,578	489	1,363	508	218	9,420	224	1,474	5,480	2,242
JUN	3,615	1,076	1,580	631	328	11,151	212	1,920	6,044	2,975
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
7 MONTHS										
1986	18,042	3,140	9,188	3,572	2,142	59,701	1,728	11,085	32,952	13,936
1985	13,343	1,263	7,628	3,413	1,039	49,522	1,445	11,491	25,526	11,060
1984	12,039	348	7,390	3,514	787	40,643	1,795	11,220	20,156	7,472
1983	8,225	425	4,469	2,792	539	30,624	1,596	6,831	16,235	5,962

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$31,132	$7,954	$13,907	$6,680	$2,591	$108,898	$16,153	$44,355	$30,732	$17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,521	24,409	56,406	56,531	23,175
JUN	49,263	12,655	23,179	10,147	3,282	151,008	32,922	56,520	39,347	22,219
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
7 MONTHS										
1986	305,135	75,998	136,090	68,407	24,640					
1985	173,371	29,942	92,749	33,241	17,439					
1984	162,382	29,098	91,017	29,886	12,381					
1983	146,079	43,645	70,116	21,581	10,737					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
JUL	320	166	42	112	153	$10,878	64	$3,971	27	$1,942	62	$4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
NOV	201	101	38	62	n.a.	n.a.	n.a.	n.a.	32	2,257	47	3,776
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1986 TOTAL	n.a.	n.a.	452	923	n.a.	n.a.	n.a.	n.a.	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
12 MONTHS												
1986	n.a.	n.a.	452	923	n.a.	n.a.	n.a.	n.a.	345	24,720	586	46,138
1985	2,193	902	251	1,040	1,261	83,306	338	19,784	193	13,047	730	50,475
1984	1,879	477	197	1,205	1,344	86,775	200	10,644	198	12,728	946	63;403
1983	1,993	777	333	883	1,307	79,470	367	19,141	286	17,966	654	42,363

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities		Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued					Applications	Issued
1986										
JUL	$3,270	$3,343	$76,197	$6,106	$8,585	$7,863	$8,518	$8,118	$14,246	$10,226
AUG	3,840	3,800	81,060	7,079	12,722	13,707	10,458	10,127	10,177	6,813
SEP	4,248	4,649	86,359	7,357	10,943	10,658	12,485	13,090	36,333	12,861
OCT	2,375	3,784	89,573	5,535	11,595	9,356	11,566	11,401	9,859	10,221
NOV	1,811	2,549	93,525	5,636	n.a.	n.a.	n.a.	n.a.	13,319	9,612
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,[illegible]68
12 MONTHS										
1986	32,987	30,826	—	60,566	89,264	90,880	82,306	80,312	152,911	98,169
1985	20,225	21,510	—	23,649	35,615	38,483	34,236	31,671	64,360	45,868
1984	21,006	16,721	—	13,546	22,669	24,269	15,505	14,158	36,101	27,857
1983	18,607	17,553	—	13,340	28,064	29,050	19,929	19,117	70,280	50,496

* FHLMC Year-to-date totals are for 10 months only

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA	CONVENTIONAL		CONVENTIONAL				
	New[4]	New	Existing	New	Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1986								
AUG	9.80%	9.88%	9.92%	10.26%	10.26%	7.96%	9.455%	11.45%
SEP	9.90	9.96	9.95	10.17	10.08	7.86	9.588	12.16
OCT	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
NOV	9.26	9.47	9.47	9.91	9.84	7.76	9.440	11.54
DEC	9.21	9.33	9.36	9.69	9.65	7.94	8.973	11.09
1987								
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
				A-Rated[7]	U.S. Government		Prime Comm. Paper
	GNMA[6]	FNMA[6]	FHLMC[6]	Utility	10-yr.	26-wk.	90-119 Days
1986							
AUG	9.11%	9.20%	9.23%	9.51%	7.17%	5.55%	5.92%
SEP	9.28	9.25	9.30	9.56	7.45	5.35	5.68
OCT	9.05	9.12	9.16	9.48	7.43	5.26	5.68
NOV	8.78	8.91	8.94	9.31	7.25	5.42	5.76
DEC	8.40	8.48	8.50	9.08	7.11	5.53	6.10
1987							
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
AUG	29	194	203	206
SEP	34	183	180	185
OCT	49	162	169	173
NOV	18	153	166	169
DEC	29	129	137	139
1987				
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields

[5] Federal Home Loan Mortgage Corp. Existing Construction only

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year-to-date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

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MORTGAGE BANKING

APRIL 1987

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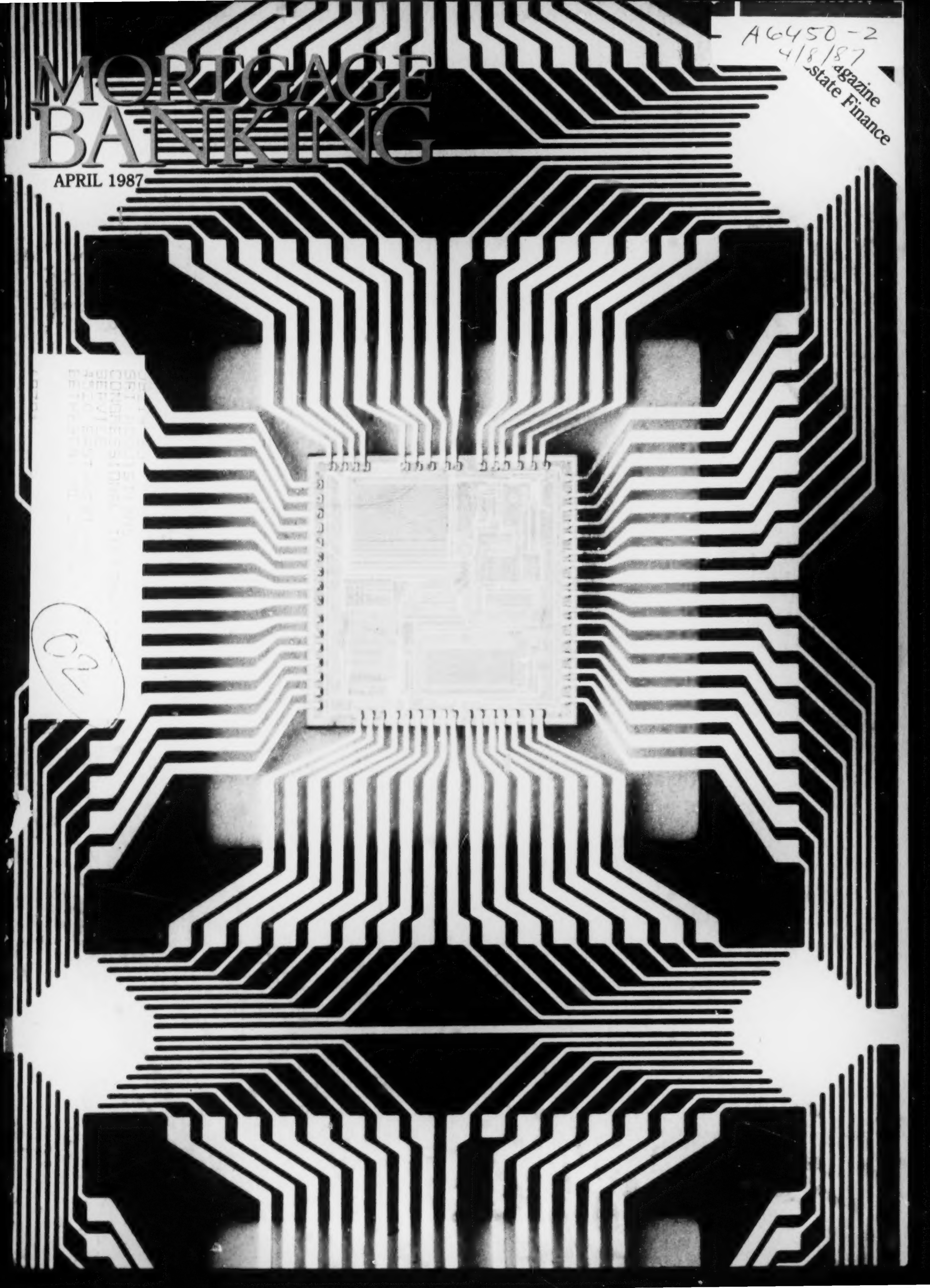

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MORTGAGE BANKING

VOLUME 47 NO. 7
APRIL 1987

ARTICLES

PAGE 8
REMICS AND CMO SYSTEMS: DON'T BE CAUGHT IN A RADISH PATCH
George Waal

A company's computer system needs to be sophisticated enough to handle the hottest new products on the market. This article outlines some of the requirements to consider on how to choose the right system to handle REMICs and CMOs.

PAGE 18
MORTGAGE INFORMATION RETRIEVAL: SORTING THROUGH ARCHIVES OF SOFTWARE
Keith Kuns and
Thomas Jarrett

With all the alternatives that exist for retrieving, processing and reporting mortgage information available to the mortgage banker, the key to choosing the correct approach depends on an individual organization's needs. A case study on how GEM Mortgage accomplished the task is presented.

PAGE 25
AN ENCOMPASSING VIEW OF THE WORLD OF REAL ESTATE FINANCE
Anthony Downs

A senior fellow from the Brookings Institute examines the future in mortgage banking. He explains the impact of the increasing tendency of savings and loans to sell into the secondary market and the effects of non-traditional players entering the business.

PAGE 51
CREATING THE ATMOSPHERE FOR SUCCESSFUL AUTOMATION
Susan J. Ellingson

Regardless of which system is chosen, it will not be successful without a total corporate commitment. The author explores the "whys" and "why nots."

PAGE 59
SHOPPING FOR A MORTGAGE IN THE 21ST CENTURY
Toni G. Willey

John and Mary Smith are new homebuyers and they are shopping for a mortgage with a telecommunications services system. This article presents mortgage lending in the 21st century where a closing can occur in 20 days.

PAGE 64
AUTOMATED UNDERWRITER: 365 DAYS A YEAR
Kenneth C. Fielder

Automated underwriting harnesses the power and speed of a computer to the application of "common sense," according to this author. It can recognize, sort and analyze a framework of logical factors that are considered in the evaluation of a credit package.

PAGE 73
TAX EFFECTS: A PERMANENT DECLINE IN HOMEOWNERSHIP?
Richard W. Peach, Ph.D.

An explanation of the effects of the Tax Reform Act of 1986 on owner-occupied and rental housing is presented in this article. Lower and moderate income families will probably opt to own instead of rent.

PAGE 89
BUSINESS BASICS DEFINING A MORTGAGE
John Oharenko and
Anatole Kolomayets

This article presents a simple but comprehensive definition for a mortgage.

PAGE 96
MEMORANDUM R-41C: AN EYE-OPENING EXAMINATION
James R. Butler, Jr.

This article summarizes the benefits, problems and issues surrounding R-41c and presents an excellent background to evaluate the possible R-41d.

PAGE 109
STRATEGIC COMPENSATION: A MANAGEMENT BATTLE
Stephen B. Matheson and
Rose Marie Orens

Management incentives are the means to achieve financial and strategic objectives. This article proposes a plan for integrating your financial, strategic and compensation plans that satisfies employers, employees and parent companies

PAGE 121
THE FATAL BLANK
Robert J. Jackson

This article describes what can happen when a blank space is left on a Truth in Lending Act form. It cost a lender $120,000 on a $134,000 loan.

PAGE 131
ERISA: THE FINAL REG FOR PLAN ASSETS
Donald J. Myers

Mortgage bankers who deal with employee benefit plans or who manage pools of mortgages will need to familiarize themselves with the Department of Labor's final regulation defining ERISA. This article provides the proper background.

PAGE 139
WHAT IS GOING DOWN AT HUD?
John K. Stewart

This author feels that if HUD were a private corporation, it would have been sued long ago for breach of contract. Has HUD dramatically and quietly reduced its commitment to public housing?

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 89
PEOPLE 144
BOOKS 148
SECONDARY MORTGAGE MARKETS 151
MORTGAGE MARKET TRENDS 153
AD INDEX 162

Richard W. Peach, Ph.D

A PERMANENT DECLINE IN HOMEOWNERSHIP?

The Tax Reform Act of 1986 represents a radical change in tax law that will certainly have significant effects on the economy. One sector of the economy that will be particularly affected by this legislation is housing, both owner-occupied and rental. While much has been made of the fact that mortgage interest and property taxes will remain deductible for homeowners, the value of those deductions will be significantly reduced, causing the after-tax cost of homeownership for both current and prospective homeowners to increase relative to the costs of other goods and services that households consume. At the same time, the lengthening of depreciation periods, the repeal of the capital gains exclusion and numerous other changes in tax law will make rental housing a much less attractive investment, thereby reducing construction of new rental housing which in time will cause rents to increase faster than they would have otherwise.[1]

On balance, these effects of tax reform are unlikely to cause a permanent decline in the homeownership rate. In fact, it is possible that the increase in rents will induce an increase in the proportion of homes that are owner-occupied, particularly for lower- and moderate-income households. At the same time, however, the increase in the cost of housing, whether owner-occupied or renter-occupied, is likely to cause a decline in the quantity of housing that households demand. This decline in demand is likely to reduce the value of the existing housing stock and reduce the amount of future investment in new housing.

The cost of homeownership When people purchase housing they must make two decisions: how much housing they want and whether they are going to buy or rent. The cost of owning one's home includes mortgage interest; property taxes; depreciation of the structure; and maintenance, insurance and utilities. Another important cost is the interest income that could be earned if the money used for a down payment and closing costs had been invested in some other asset. Mortgage interest and property taxes are deductible, while the implicit net income realized from the equity in the home is not taxed. Thus, homeownership typically results in tax savings for the homeowner, which

> "One sector of the economy that will be particularly affected by this legislation is housing, both owner-occupied and rental."

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makes the after-tax cost of homeownership significantly less than the before-tax cost. The after-tax cost of homeownership is the true cost and thus influences the quantity of housing demanded and so the value the market places on a given property. The cost of homeownership relative to the cost of renting comparable housing influences the tenure choice decision.

Overview of the Tax Reform Act of 1986

Table 1 provides a side-by-side comparison of the provisions of the previous tax law that determine an individual's federal tax liability and the after-tax cost of owner-occupied homes with those same provisions under the Tax Reform Act of 1986. With regard to the after-tax cost of homeownership, the relevant features of the new tax law are (1) a reduction of marginal tax rates, (2) an increase in the zero bracket amount (ZBA) or standard deduction, (3) an increase in the personal exemption, and (4) the limitation or repeal of previously allowed non-homeownership deductions.

The combined effect of these changes is to raise the after-tax cost of owner-occupied homes by reducing the value of homeownership itemized deductions. The reduction in marginal tax rates directly reduces the value of all itemized deductions so that a given dollar amount of deductions results in a reduced amount of tax savings. For

TABLE 1

Comparison of Individual Income Tax Provisions Under 1986 Tax Law and the Tax Reform Act of 1986

	1986 Tax Law	Tax Reform Act of 1986
PERSONAL MARGINAL TAX RATES	14 rate brackets from 11% to 50%	2 rate brackets: 15%, 28%[a]
EXEMPTIONS		
Self, spouse	$1,080	$2,000[b,c]
Dependents	$1,080	$2,000[b,c]
Elderly	$1,080	Repealed
Blind	$1,080	Repealed
ZERO BRACKET AMOUNTS or Standard Deductions		
Single	$2,480	$3,000[d]
Joint	$3,670	$5,000[d]
Head of Household	$2,480	$4,400[d]
INDEXED RATE BRACKETS, EXEMPTIONS AND ZBA	Yes	Yes, beginning in 1989
PERSONAL DEDUCTIONS		
Mortgage Interest		
Principal Residence	Deductible	Deductible on mortgage debt up to 100 percent of original purchase price plus improvements[e]
Secondary Residence	Deductible	Deductible for one secondary residence on mortgage debt up to 100 percent of original purchase price plus improvements[e]
Other Personal Interest	Deductible Investment interest limited to $10,000 plus investment income	Nondeductible Investment interest limited to investment income. Four-year phase out[f] (Expanded definition of interest subject to limit)[g,h]
Real Property Taxes	Deductible	Deductible
Personal Property Taxes	Deductible	Deductible
State and Local Income Taxes	Deductible	Deductible
State and Local Sales Taxes	Deductible	Non-deductible
Medical Expenses	Deductible, above 5% of AGI	Deductible, above 7.5% of AGI
Charitable Contributions	Deductible for itemizers and for non-itemizers (non-itemizers deduction expires after 1986)	Deductible for itemizers but not for non-itemizers
Miscellaneous Deductions	Yes, for itemizers only	Yes, above 2% of AGI for itemizers only
Two-Earner Deduction	Yes, 10 percent of lower salary	Repealed
Child Care Credit	Credit from 20% to 30% on expenses up to $2,400 per child	Same as 1986 tax law

example, where $1 of itemized deductions results in $0.25 of tax savings with a 25 percent marginal tax rate, tax savings are reduced to $0.15 with a 15 percent marginal tax rate. Increasing the ZBA or standard deduction also reduces the value of a given dollar amount of itemized deductions because it is the amount of such deductions above the ZBA which reduces taxable income. Increasing the value of the personal exemption tends to reduce the value of itemized deductions because for a given level of gross income, a larger personal exemption results in a lower taxable income. Thus, it is likely to result in a lower marginal tax rate. Finally, the limitation or repeal of non-homeownership deductions tends to reduce the value of homeownership deductions by reducing the total dollar amount of itemized deductions in excess of the standard deduction.

A simplified example

Consider the following simplified example, frequently used in residential sales presentations, of the determination of the after-tax cost of homeownership. As presented in Table 2, assume that a taxpayer recently purchased a $100,000 home with a 20 percent down payment and an $80,000 mortgage with a fixed interest rate of 10 percent and a 30-year term. Property taxes are assumed to be 1.23 percent of the home value, the nationwide average for single-family homes.[2] The before-tax cost of owning this home would be $9,230 ($8,000 of mortgage interest and $1,230 of property taxes). Based on industry-wide underwriting criteria, a minimum income of $30,100 would be required to qualify for this mortgage. It is further assumed that this taxpayer files a joint return with four exemptions. On average, this taxpayer is likely to have non-housing itemized deductions (i.e., state and local taxes, non-mortgage interest, etc.) roughly equal to the 1986 tax law standard deduction or ZBA of $3,670 (about 12.2 percent of gross income). Therefore, under the old law, the full amount of homeownership deductions of mortgage interest and

	1986 Tax Law	Tax Reform Act of 1986
FRINGE BENEFITS		
Health Insurance	Not taxed	Same as 1986 tax law
Group-Term Life Insurance Premiums	Premiums for insurance more than $50,000 taxed	Same as 1986 tax law
Dependent Care Assistance	Not taxed	Same as 1986 tax law
RETIREMENT SAVINGS		
IRA limit Spousal IRA	$2,000 $250	Repealed for individuals who are active participants in an employer-sponsored retirement plan with AGI (before IRA deduction) in excess of $50,000 (joint return) or $35,000 (single return). Non-deductible contributions can be made up to $2,000 ($250 for spousal contribution) with continued deferral of tax on earnings
401(k) plans	Annual maximum combined employee/employer contributions the lesser of $30,000 or 25% of non-deferred compensation	$7,000 annual maximum for employee, the lesser of $25,000 or 25% of compensation maximum combined employee/employer
OTHER INDIVIDUAL ITEMS		
Rollover of Capital Gains on Principal Residence	Capital gain tax deferred if seller purchases another residence costing at least as much as the one sold within two years	Same as 1986 tax law
One-time Exclusion on Capital Gains on Principal Residence	One-time exclusion of gains up to $125,000 on sale of principal residence for taxpayers 55 or older	Same as 1986 tax law
Income Averaging	Yes	Repealed
MUNICIPAL BONDS		
Mortgage Revenue Bonds (MRBs)	Tax-exempt with volume restrictions; authority to issue expires December 31, 1987	Tax-exempt, with greater targeting toward lower income individuals and more restrictive volume limitations; sunset date extended to December 31, 1988

[a] Individual tax rates in 1988 for a joint return are:

Taxable Income	Rate
$0–$29,750	15%
$29,751 and over	28%

The benefit of the 15 percent marginal rate is phased out by a 5 percent surtax for higher income taxpayers with taxable income between $71,900 and $149,250 (joint returns) or between $43,150 and $89,560 (single return). Thus, the effective marginal tax rate in these ranges is 33 percent.

[b] The personal exemption is increased to $1,900 in 1987; $1,950 in 1988; and $2,000 in 1989

[c] Beginning in 1988, the personal exemption would be phased out by a 5 percent surtax on the amount of taxable income in excess of $149,250 for joint returns until the benefit of the personal exemption is exhausted. The phase-out range extends for $11,200 of taxable income for each exemption claimed, over which the effective marginal rate remains at 33 percent.

[d] These amounts are raised by $600 for elderly and for blind taxpayers

[e] Interest on mortgage debt exceeding 100 percent of original purchase price plus improvements would be deductible if incurred to meet education or medical expenses

[f] Under the phase-out, the percentage of personal interest deductions disallowed are as follows: 1987, 35 percent; 1988, 60 percent; 1989, 80 percent; 1990, 90 percent; 1991, 100 percent.

[g] Included in the definition of interest subject to limitation is the taxpayer's share of all interest expense of S corporations in which the taxpayer is not actively engaged in management and the taxpayer's distributive share of all interest expense of limited partnerships in which the taxpayer is a limited partner. The proposal would also include as investment interest the taxpayer's share of the interest expense of certain trusts and other entities in which he is a limited entrepreneur.

[h] Interest from any activity subject to the passive loss limitation will not be treated as investment interest.

TABLE 2

Simplified Example of the Impact of Tax Reform on Annual After-tax Homeownership Costs

	1986 Tax Law	Tax Reform Act of 1986
Before-tax Homeownership Costs		
Mortgage interest	$ 8,000	$ 8,000
Property taxes	1,230	1,230
Total	$ 9,230	$ 9,230
Itemized Deductions		
Homeownership Deductions		
Mortgage interest	$ 8,000	$ 8,000
Property taxes	1,230	1,230
Non-homeownership Deductions	3,670	2,000
Subtotal	$12,900	$11,230
Less: ZBA or Standard Deduction	$ 3,670	$ 5,000
Total Itemized Deductions	$ 9,230	$ 6,230
Homeownership Tax Savings	9,230 × 0.25 = 2,308	6,230 × 0.15 = 935
After-Tax Homeownership Cost	$ 6,922	$ 8,295
Change: $	—	+$ 1,373
%	—	+19.8%

TABLE 3

Impact of the Tax Reform Act of 1986 on Annual After-tax Homeownership Costs

		Annual After-Tax Cost			
Home Price	Corresponding Income	1986 Tax Law	Tax Reform Act of 1986	Change $	Change %
$ 50,000	$ 15,000	$ 4,683	$ 5,045	$ 362	7.7%
75,000	22,600	6,705	7,299	594	8.9
100,000	30,100	8,515	9.492	977	11.5
150,000	45,200	11,576	13,228	1,652	14.3
200,000	60,200	14,308	15,506	1,198	8.4
300,000	90,300	19,166	22,578	3,412	17.8
500,000	150,440	30,455	35,717	5,262	17.3

property taxes would be evaluated at a 25 percent marginal tax rate. With itemized deductions in excess of the ZBA of $9,230, these deductions result in $2,308 of tax savings, which bring the after-tax cost of owning this home down to $6,922.[3]

Under tax reform the after-tax cost of owning this home will rise significantly due to the impact of three changes:

- Lower marginal tax rates;
- A higher ZBA or standard deduction;
- Repeal or limitation of many non-housing itemized deductions.

Referring again to Table 2, under the Tax Reform Act of 1986, the non-homeownership itemized deductions decrease to about $2,000 for this taxpayer while the standard deduction is increased to $5,000. The net impact of these changes is to reduce the dollar amount of homeownership deductions that will provide tax savings by $3,000, from $9,230 to $6,230. In addition, that reduced amount of allowed homeownership deductions is evaluated at a 15 percent marginal rate. The bottom line is that the homeownership tax savings have declined from $2,308 to $935, thereby boosting the after-tax homeownership cost by $1,373 or 19.8 percent.

More detailed estimates

Table 3 provides more detailed estimates of the increase in after-tax homeownership costs resulting from tax reform for seven representative home prices. Included in these estimates are the tax considerations of the funds used for the down payment, the income from which goes untaxed for

TABLE 4

Impact of the Tax Reform Act of 1986 on Federal Tax Liabilities[a]

		Tax Liability of Homeowners				Tax Liability of Renters			
Home Price	Corresponding Income	1986 Tax Law	Tax Reform Act of '86	Change $	Change %	1986 Tax Law	Tax Reform Act of '86	Change $	Change %
$ 50,000	$ 15,000	$ 336	$ −1	$ −337	−100%	$ 966	$ 335	$ −631	−65.3%
75,000	22,600	984	992	+8	+0.8	2,250	1,658	−592	−26.3
100,000	30,100	1,762	1,709	−53	−3.0	3,875	2,835	−1,040	−26.8
150,000	45,200	3,524	3,132	−392	−11.1	7,899	5,849	−2,050	−26.0
200,000	60,200	5,425	4,539	−886	−16.3	12,387	10,245	−2,142	−17.3
300,000	90,300	10,800	9,806	−994	−9.2	23,535	19,119	−4,416	−18.8
500,000	150,400	24,401	21,050	−3,351	−13.7	47,074	38,494	−8,580	−18.2

[a] Assumes a one-earner family of four.

the homeowner. All tax calculations are based on the minimum incomes required to purchase such homes assuming a 10 percent mortgage interest rate, a 20 percent down payment and industry-wide lending criteria.

Note that in general the percentage increase in after-tax cost rises as income rises, due to the fact that the tax rate schedule under the Tax Reform Act of 1986 is considerably less progressive. However, there are some income ranges, such as around $60,000, where this general rule is violated because the percentage reduction in marginal tax rates suddenly declines and then increases again as one moves up the income scale. It is also interesting to note that in the low- and moderate-income ranges, $15,000 and $22,600, marginal tax rates actually increase. In those cases the increase in the after-tax cost of homeownership is due entirely to the increase in the standard deduction.

Impact on federal tax liability

Because the demand for owner-occupied housing is not totally insensitive to changes in its price, these increases in after-tax cost are likely to reduce the demand for housing, causing the value of the existing stock of homes to decline. However, in order to estimate this potential decline in value, it is necessary also to determine the impact of tax reform on overall federal tax liability, because a reduced tax burden could offset somewhat the increase in after-tax homeownership costs.

Table 4 presents estimates of the likely impact of the Tax Reform Act of 1986 on the federal tax liability of homeowners with adjusted gross incomes equal to the minimum incomes required to purchase such homes. These tax calculations assume a family of four filing a joint return. All non-housing itemized deductions are averages for itemizers at the corresponding income levels, while the homeownership deductions are typical of recent homebuyers. This analysis reveals that while it is true that aggregate personal taxes are reduced by tax reform, it is not true that every individual taxpayer would realize a significant decline in federal tax liability. Indeed, in general the tax liability of non-itemizing taxpayers would decline significantly, while the tax liability of individuals who do itemize (particularly middle-income homeowners) is very likely to remain essentially unchanged.

Net impact of tax reform

With the after-tax cost of owning one's home increased significantly while federal tax liability is either essentially unchanged or reduced by much less than the increase in the cost of homeownership, the financial situation of recent and prospective homeowners is worsened by tax reform. As shown in Table 5, the after-tax cost of homeownership would absorb 33.4 percent of disposable income under the Tax Reform Act of 1986 compared to 30.0 percent under the old law, assuming the cost of the home remains unchanged. This is roughly the equivalent of a 1.6 percentage point increase in mortgage interest rates. Table 6 presents this same calculation for all of the income levels analyzed in this report, confirming that at most income levels, homeowners turn out to be net losers under tax reform. The data also suggest that households purchasing homes in the $75,000 to $150,000 range, which represents about half of all homes currently being sold, would fare the worst in relative terms.

Impact on home values

Owner-occupied homes are income producing assets, the value of which is influenced by the implicit income stream they provide, net of carrying costs and taxes. An increase in the after-tax cost of owning a home, whether due to an increase in carrying costs, such as an increase in mortgage interest rates, or due to a change in tax law, reduces this net income stream and so reduces the value of such assets to all potential buyers. Table 7 presents estimates of the potential impact on home values, assuming that home values adjust so that the annual after-tax cost of homeownership remains a constant proportion of disposable income. Estimates are provided assuming that mortgage rates remain unchanged and assuming that tax reform leads to a 100 basis point or 1 percentage point decline in mort-

TABLE 5

Impact of the Tax Reform Act of 1986 on a Homeowner's Disposable Income[a]

	1986 Tax Law	Tax Reform Act of 1986	Change
Adjusted Gross Income	$30,100	$30,100	$ —
Federal Tax Liability	$ 1,762	$ 1,709	$ −53
Disposable Income	$28,338	$28,391	$ +53
After-tax Homeownership Costs	$ 8,515	$ 9,492	$ +977
Percent of Disposable Income	30.0%	33.4%	—
Non-housing Disposable Income	$19,823	$18,899	$ −924

[a] Based on the case of a $100,000 home, which would require a minimum income of $30,100 to purchase, assuming a 20 percent down payment and a 10 percent mortgage interest rate

TABLE 6

Net Impact of Changes in After-tax Homeownership Costs and Federal Tax Liability on Homeowner's Non-Housing Disposable Income

		Non-Housing Disposable Income			
Home Price	Corresponding Income	1986 Tax Law	Tax Reform Act of 1986	Change	
				$	%
$ 50,000	$ 15,000	$ 9,981	$ 9,956	$ −25	−0.3%
75,000	22,600	14,911	14,309	−602	−4.0
100,000	30,100	19,823	18,899	−924	−4.7
150,000	45,200	30,100	28,840	−1,260	−4.2
200,000	60,200	40,467	40,155	−312	−0.8
300,000	90,300	60,334	57,916	−2,418	−4.0
500,000	150,440	95,584	93,673	−1,911	−2.0

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gage interest rates.

Barring a decline in mortgage interest rates, home values are likely to fall across the board as a result of the Tax Reform Act of 1986. In general, the relative potential decline in home values rises as current home value increases, although there are some ranges of home prices where this general rule is violated such as with the increase in after-tax cost that has been discussed. In the $75,000 to $150,000 price range, which represents the bulk of all single-family home sales, prices would likely fall 9 to 12 percent. Somewhat greater percentage declines—12 to 14 percent—would likely occur for homes currently valued in excess of $200,000.

At this time, the jury is still out on the issue on whether or not tax reform will induce a general decline in interest rates. Nearly all researchers on this issue have concluded that tax reform is likely to lead to a decline in aggregate investment, which by itself would reduce interest rates. A decline of about 100 basis points in long-term rates has been estimated as the likely magnitude of decline by at least two sources. However, other researchers have concluded that interest rates are not likely to decline because, while aggregate investment demand is reduced, so is the aggregate supply of private savings, particularly business savings in the form of depreciation allowances and tax credits.[4] However, should it occur, a 1 percentage point decline in mortgage interest rates would largely offset the increased tax burden on owner-occupied homes. In this case only modest declines in value in the upper home price range would be likely. In the middle price range essentially no change in value would be likely, while the possibility exists for some modest price increases in the lower and moderate price range. However, it should be emphasized that the increase in tax burden on owner-occupied homes is definite, whereas the potential decline in interest rates is conjectural.

Several points with regard to these potential declines in home values should be noted. First, to the extent that they do occur, such value adjustments are likely to be largely imperceptible. Home prices are rising about 6 percent to 8 percent a year on a nationwide average basis. A downward value adjustment would probably take the form of a somewhat slower rate of appreciation during the course of a few years than otherwise would be the case. Only in depressed market areas where home values have been flat or already declining is tax reform likely to induce an absolute decline in home values.

Second, contrary to what some advocates of tax reform have asserted, a decline of home values due to these changes in tax law would not benefit first-time buyers or current homeowners who would like to upgrade their housing.[5] For example, under current law the annual after-tax cost of a $100,000 home is about $8,500 or about $710 per month. Under the Tax Reform Act of 1986, that after-tax cost would rise to about $9,500, or $790 per month. This increase in after-tax cost is likely to prompt a decline in value of about 10.8 percent or about $10,800, assuming mortgage rates are unchanged. This decline in value would cause the after-tax cost to fall back to about $710 per month. The

TABLE 7

Potential Impact on Home Values Due to Tax Reform

	Tax Reform Act of 1986			
Home Price	Mortgage Rates Unchanged		Mortgage Rates Decline by 100 Basis Points	
	$	%		
$ 50,000	$ −2,874	−5.7%	+2,019	+4.0%
75,000	−6,649	−8.9	+450	+0.6
100,000	−10,795	−10.8	−1,533	−1.5
150,000	−17,916	−11.9	−4,195	−2.8
200,000	−12,778	−6.4	+6,660	+3.3
300,000	−42,240	−14.1	−15,475	−5.2
500,000	−61,663	−12.3	−16,145	−3.2

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point is that, regardless of whether the home costs $100,000 under the old law or $89,200 under the new tax laws, it is still going to cost the homebuyer $710 per month after-tax to own the home.

Finally, several commentators have expressed doubts about the increased tax burden on owner-occupied housing resulting in a decline in value. Those doubts are based not on the expectation of declining interest rates but on what can be referred to as the "last tax shelter" argument. It is argued that because nearly all other tax shelters have been closed by this legislation, the demand for owner-occupied housing will actually increase, due to the fact that mortgage interest and property taxes remain deductible. Further, because consumer interest will no longer be deductible, the demand for owner-occupied housing will increase. People will use the equity in their home to fund purchases of other goods, such as automobiles, so that interest will remain deductible. (In order for this interest to remain deductible for expenditures for things other than medical or education expenses, total mortgage debt is limited to the original purchase price of the home plus improvements.)

Upon closer examination, however, these arguments are not very compelling. To begin with, for most households, homeownership has always been both the primary "tax shelter" and the primary vehicle for accumulating wealth. Tax return data confirm that only a very small fraction of mostly high income households have ever invested in the types of tax shelters, such as real estate or equipment leasing limited partnerships, that this legislation curtails. Other sources of information on households' assets and liabilities, such as the 1983 Survey of Consumer Finances, indicate that for the bulk of households the equity in the home they own has traditionally been their primary source of net worth and that this wealth has been used to fund major expenditures such as a college education. Thus, it is doubtful that such considerations behind the demand for homeownership will be much intensified by tax reform.

It is generally recognized that the Tax Reform Act of 1986 significantly increases the tax burden on so-called income producing real estate such as

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office buildings and shopping centers. This increased tax burden is expected to reduce the value of existing income properties and reduce the level of investment in new properties. Due to the fact that under tax reform mortgage interest and property taxes remain deductible for homeowners, it is not generally recognized that the tax burden on owner-occupied homes is also increased due to a significant decline in the value of these homeownership deductions. Consequently, a similar type of market reaction to this increase in tax burden can be expected. Interestingly, however, the proportion of households who own the home they live in, the homeownership rate, may actually increase as a result of tax reform even though the aggregate amount of housing, whether renter- or owner-occupied, that households demand is likely to decline. The reason for this is that while the after-tax cost of owning a home is expected to increase, the cost of renting is expected to increase even more. Thus, many households, particularly those in the lower and moderate income ranges where the homeownership rate is relatively low, are likely to react to this increase in the relative price of renting by opting for homeownership.

These estimates of potential decline in home value implicitly assume unitary price and income elasticities of demand for owner-occuped housing. Other researchers have used different elasticities and as a result have derived different estimates of the impact of tax reform on home values. □

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[1] See Peach, Richard W., "The Impacts of Tax Reform on Commercial and Rental Residential Real Estate," mimeo.

[2] Source: Advisory Commission on Intergovernmental Relations.

[3] Actual tax savings is likely to be somewhat less. While the last (marginal) dollar of homeownership deductions would be evaluated at a 25 percent marginal rate, the preceding dollars (intra-marginal) would be evaluated at lower marginal rates due to the progressive marginal tax rate structure.

[4] Some general equilibrium analyses have suggested that tax reform, by depressing aggregate investment demand, may cause interest rates to decline. See for example Hendershott, Patric H., "Tax Reform and the Slope of the Playing Field," in *Taxes and Capital Formation*, edited by Martin Feldstein, National Bureau of Economic Research, Inc., Prepublication Report; and Prakken, Joel L.; Laurence H. Meyer; and Chris P. Varvares, "The Senate Finance Committee Proposal for Tax Reform, A Macroeconomic Analysis," Center for the Study of American Business, May 23, 1986. Both of these studies suggest that the Senate Finance Committee proposal, which is very close to the final bill, would reduce interest rates about 1 full percentage point, However, it should be noted that not all analysts have concluded that tax reform of the House and Senate Finance Committee proposals type would cause interest rates to decline. For example, see Brinner, Roger E., "The Economic Consequences of Tax Reform as Proposed by the House of Representatives," Data Resources, Inc., January 1986.

[5] See for example, Michael Kinsley, "Viewpoint," Wall Street Journal, June 5, 1986.

[6] Source: 1983 Survey of Consumer Finances, Board of Governors of the Federal Reserve System.

[illegible]

What Is Going Down At HUD ?

[illegible]

The proposed tax simplification bill, now law, is universally newsworthy. And why not? It offers apparent simplicity, would put cash in the pockets of almost all classes of taxpayers, purportedly eliminates loopholes, shifts more of the income burden to corporations, and is "revenue neutral," so say the economists. But recall that people who laugh at gypsy fortune tellers actually take economists seriously.

One of the bill's cornerstones is the rapid elimination of the passback of tax losses on real estate limited partnerships. This radical surgery is being performed without distinction between housing for the well-to-do and those of modest means notwithstanding that tax losses have historically been the economic grist for the production of housing for families of low income. Further, the bill breaks new ground by rapidly phasing out the use of these tax losses, even for low income housing partnerships *already in existence*, which are almost totally tax-loss driven and to which the government is a contractual party. The relevant department of the government is the United States Department of Housing and Urban Development (HUD) which has, for years, implicitly and explicitly promoted tax shelters through its legislation as an instrument of national policy as a means of providing shelter for families who could not afford to pay market level rents. The effect of this action will be devastating on this segment of the housing market.

Does this element of the tax bill represent a non-recurring economy measure, or is it part of a continuum reflecting a larger long-term policy?

Programs and funding

At a programmatic level, first take a look at what has happened during the short space of the last seven years since the current administration took over. There are a couple of punch line statistics which provide telltale clues:

- Without a lot of fanfare—because renters of low income housing do not represent a particularly strong and organized constituency—the number of assisted housing units constructed annually in the United States has dropped from an average level of approximately 250,000 units a year under Presidents Nixon, Ford and Carter to a current level of about *one-fourth* that size;
- The federal budget for HUD has plummeted from 35.7 billion dollars for fiscal year 1980 to a proposed 5.5 billion for fiscal year 1987 (an 85 percent reduction).

The aforementioned statistics do not suggest a mere fat-trimming; rather, they indicate something more in the nature of a program dismantling. Take, for example, HUD's single largest program for housing low income families, entitled Section 8. This program provides gap payments to developer/sponsors for the difference between the actual cost of operating a rental project and approximately 30 percent of the tenant's income. It is the mainstay of the department, creating newly constructed and rehabilitated rental units. (See Example 1)

Section 8 production for fiscal year 1986 will be virtually nil.

But what about HUD's other housing programs? The effective 221(d)(3) below-market interest (3 percent) rental program has been canceled. The Section 236 low interest (1 percent) rental program—HUD's second largest—has also been eliminated. Even the subsidized condominium program (Section 235) was scrubbed in 1980 notwithstanding the benefits of giving moderate income families an opportunity for first-time homeownership.

Net loss

A compounding factor should be mentioned. Because of expiring Section 8 subsidy contracts and early mortgage payments, the current nationwide inventory of 1.9 million units will decrease between 200,000-900,000 units during the next nine years. Given the virtual elimination of new housing production, the affordable housing inventory in America will likely experience a net loss between now and 1995.

HUD was created after World War II with a number of purposes—principal among which was to produce housing for low and moderate income families in America. Quietly but surely, the administration has relegated HUD to be a caretaker agency without production tools. Recent statistics indicate that the homeless are 36-38 years of age on average, 20 percent female, with 40 percent having some education beyond high school. The principal cause of the dramatic rise in the homeless is the absence of homes.

Most low and moderate income housing produced in America in the last 20 years has been through for-profit mortgagors in the form of limited partnerships. Typically, such partnerships have a general partner who is responsible for the development and operation of the project and who is financially liable in the event of cash shortfalls or foreclosure. The project's equity needs (i.e., capital in excess of the mortgage) are funded primarily through limited partners who are investors without management input but at risk to the extent of their investment (subject to certain exceptions upon foreclosures). HUD-sponsored rental programs have certain important distinctions vis-a-vis the normal garden apartment alive and well in the San Fernando Valley:

- The renter's income may not exceed 80 percent of the area median income;
- Rent increases are subject to review and control by HUD;
- Cash throw-off, if any, is severely limited (a maximum 6 percent on equity, but in practice, less than half that amount); and
- Long-term 20-to-40-year "lock-ins" which, through recorded deed, provide for continuing affordability to low income families.

EXAMPLE 1

Section 8 Units Completed* During Fiscal Years 1975-1985

Year Completed	No. of Units
1975	178
1976	5,628
1977	24,658
1978	77,441
1979	116,679
1980	174,425
1981	150,891
1982	168,282
1983	175,398
1984	157,166
1985	56,175
	1,106,921

*Source United States General Accounting Office Report 6/16/86 to Subcommittee on Employment and Housing, U.S. House of Representatives

> ***"One of the bill's cornerstones is the rapid elimination of the passback of tax losses on real estate limited partnerships."***

John K. Stewart is president of the John Stewart Company of Sausalito, California, a firm specializing in project acquisition rehabilitation, syndication, management, consulting, marketing and development. Mr. Stewart was formerly an officer in a TRW-owned subsidiary corporation which developed public and HUD-assisted and insured housing.

With virtually no cash flow and long-term restrictions on resale in the open market, why would any prudent businessman subject himself or herself to such a thin risk/reward ratio? In every single one of these government-promulgated tax-driven programs, losses were passed on to the limited partner investors in lieu of cash. This was the primary economic incentive. It also had the effect of keeping rents down because investor reward was a matter of tax reduction on April 15 as opposed to cash from project operations.

This arrangement was no unspoken Faustian pact. It was a matter of national policy. In fact, the Internal Revenue Service itself produced a ruling (#79-300) which clearly acknowledges that tax losses from Section 236 rental projects were intended to encourage private investment in low income housing. Further, and most importantly, the ruling, so as not to frustrate congressional intent, held that this kind of housing need not meet the same economic substance test required of other real estate. For purposes of allowable tax losses, the administration is now proposing to wipe all of that out, not only future developments (that is fair enough in the sense that it is at least prospective), but egregiously also for existing partnerships already in place.

Is this an isolated incident?

More rule changes

About 1973, HUD initiated a new program entitled "rent supplement," which provided a forty-year project-based subsidy for tenants residing in a given housing complex. The resident made a "tenant contribution" equal to approximately 25 percent of gross adjusted income. HUD made up the difference between that figure and the actual market rent. The owner entered into a convenant to maintain the property as affordable to low and moderate income families, for which the project was guaranteed a forty-year subsidy commitment. However, in 1983, the program was effectively canceled by reason of a freeze on all rent supplement funding. Owners were offered what amounted to a Hobson's choice: They could either accept a defunct program with fixed funding which made no provision for inflation,

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or accept a new similar program (Section 8) which was, however, shortened from 40 to 50 years.

There is an interesting, but troubling parallel to the current tax bill as it affects low-income housing. We again see the federal government reneging on its commitment after owners/sponsors had entered into contract to build and operate housing for which they had full liability. The question of what happens to the financial viability, and more importantly, the occupants of a project when its subsidy runs out far short of the original 40-year commitment, has not been addressed as of this writing by HUD or Congress.

In the late 1970s, HUD came out with a new program entitled "flexible subsidy," the purpose of which was to provide either grant funds or low interest loans to troubled properties in exchange for capital contributions from owners and a commitment to "maintain the low and moderate income character" of the project for the life of the mortgage. The life of the mortgage was typically 40 years and was coterminous with the rent supplement commitment. As previously noted, HUD reneged on its rent supplement commitment in 1983, cutting the subsidy term from 40 to 15 years. However, they did not see their way clear to remove the long-term restrictions in their rent supplement program. In short, owners are being asked to guarantee long-term affordability without the previously agreed upon subsidy.

Yet another example of a "midcourse correction" emanating from the department comes to mind. The department is now promulgating new regulations which will require owners to put public housing tenants at the head of their current waiting lists on Section 236 developments. From HUD's point of view, this is understandable because they have dramatically and quietly reduced their commitment to public housing. What better solution than to shift the burden to the various 236 sponsors thoughout the country? It is important to note that these owners entered into these programs with the specific written commitment that projects would be targeted to families with incomes above public housing levels.

The writer's complaint is not that there should not be housing for the public housing constituency—the current administration has been woefully inadequate in this regard—but rather that the 236 programs were never intended for this tenancy. The new regulations which will be issued by HUD imminently will effectively place private sector partnershps in the public housing business, again on an after-the-fact basis. Again, that was not the original deal.

This suggests that if HUD were a private corporation, they would have been sued long ago for breach of contract, detrimental reliance and bad faith.

The tax reform bill has a section intended to serve as the new principal incentive for the production of low income housing. The guts of this mini-housing program is not a return to cash throw-off but, paradoxically, rather a forward stream of tax credits for 10 years from project inception. While the intent of this provision of the bill is laudable, it may be unwise to rely upon a promise of a future tax benefit. □

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MORTGAGE MARKET TRENDS

Large increases in employment and industrial production during January and February suggest that real GNP growth is strengthening considerably in the first quarter of 1987 relative to its anemic performance in the fourth quarter of last year. At the time of this writing, a first quarter growth rate of 3 percent, or higher, appears likely. The primary stimulus to GNP growth during the first quarter appears to be a pick-up of business investment in inventories. Growth is likely to slacken somewhat during the second quarter as the rapid pace of inventory investment subsides. During the four quarters of 1987, real GNP is expected to increase about 2 3/4 percent, compared to 2.1 percent in 1986. Improvement in real net exports is expected to be the driving force behind this reasonably optimistic economic forecast.

Although first quarter GNP statistics will not become available until late April, it is a reasonable guess that the principal contributor to growth in the first three months will be a sharp rise in non-farm inventory investment. The increase in manufacturers' inventories in January is consistent with this notion. Inventories in the non-farm sector declined sharply in the fourth quarter, prompting increases in production to replenish depleted stocks. These increases in production have led to gains in manufacturing employment and a lengthening of the average work week in the industrial sector. As a result, aggregate hours worked in manufacturing rose at an annual rate of 7 percent during the first two months of the year. Coupled with the gains in the service industry, total employment at non-farm establishments rose by an average of 328 thousand per month in January and February.

The stimulus to growth from rising inventory investment early this year will be replaced by growth in other components of GNP as the year progresses, most likely real net exports. This expected improvement stems in large measure from the effect the dollar's decline in foreign exchange markets has had on our competitive position in world trade. However, it should be noted that this improvement is in real or physical volume terms. Monthly statistics on the merchandise trade balance, which are measured in current dollars, are likely to show little if any improvement because import prices are likely to increase significantly faster than export prices.

The dependence on an improvement in real net exports as a source of growth reflects the fact that demand in other major sectors of the economy is expected to be comparatively weak this year. One reason for this anticipated softness is tax reform, which increased spending by businesses and consumers late last year, but is expected to have a negative impact on economic growth early in 1987. Recent statistics appear to validate this expectation. New orders for non-defense capital goods fell sharply in January. Retail sales declined 7 1/2 percent in January, due to a steep drop in auto sales. Retail sales recovered somewhat in February, but the average level for January and February was below the average for the fourth quarter of 1986. For the year, consumer spending should still increase but at a much slower pace than in the past few years.

Business fixed investment is expected to rise very modestly in 1987. The latest Commerce Department survey of businesses spending plans confirms this expectation. According to this report, real capital spending is estimated to increase just 0.2 percent in 1987. Non-residential building activity is likely to be particularly weak. In real terms, non-residential building construction declined for the fifth consecutive month in January, this time by 4 percent. Given the high level of vacancy rates, and the reduction of tax incentives for commercial construction, further declines in non-residential building activity seem likely.

In the residential area, housing starts were essentially unchanged in January, remaining at the relatively high 1.8 million unit pace established in December. At an annual rate, starts of one- to four-unit residences totalled 1.25 million units, while multifamily starts equalled 476,000. Sustained by low mortgage rates, single-family starts should remain near their present levels for the rest of 1987. Starts of multifamily units however, are expected to fall to about 420,000 units as the year progresses. As with commercial construction, the drop in multiunit starts is due to high vacancy rates and the impact of tax reform.

The outlook for inflation in 1987 is less favorable than it was last year. One reason is that last year's declines in oil prices are giving way to modest increases this year. In addition, the drop in the value of the dollar is beginning to increase import prices, which in turn has allowed domestic manufacturers to raise prices as well. These price increases can already be seen at both the consumer and producer levels. In January, the consumer price index and the producer price index registered relatively large increases of 0.7 percent and 0.6 percent, respectively.

A mitigating factor in the inflation picture in 1987 is expected to come from continued moderate increases in wage rates. Wage rate increases decelerated in 1986, and are not likely to turn up significantly in an environment of moderate economic growth in 1987. On the whole, although monthly price changes will be somewhat volatile, consumer and producer price increases significantly in excess of 4 percent seem unlikely this year.

On balance, given the moderate rate of growth that is anticipated and the projected rise in inflation, both short-term and long-term interest rates are expected to fluctuate within a fairly narrow range, remaining near their current levels for the near future. Presently, rates on 3-month Treasury bills are averaging about 5 1/2 percent, while yields on 30-year Treasury bonds are slightly over 7 1/2 percent. Rates on conventional fixed-rate mortgages are hovering around the 9 percent range.

Robert Rosenblatt
March 13, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
AUG	164	117	47	1,800	1,268	532	144	100	44	1,673	1,147	526
SEP	154	108	46	1,689	1,185	504	152	103	49	1,603	1,144	459
OCT	155	109	46	1,657	1,199	458	146	103	43	1,565	1,109	456
NOV	116	83	33	1,637	1,200	437	109	72	37	1,613	1,083	530
DEC	114	80	34	1,808	1,334	474	132	82	50	1,910	1,282	628
1987												
JAN$_{p}$	105	75	30	1,806	1,330	476	98	67	31	1,689	1,184	505
1986 TOTAL	1,806	1,263	543				1,762	1,186	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
1 MONTH												
1987	105	75	30				98	67	31			
1986	116	79	37				119	74	45			
1985	105	66	39				104	64	40			
1984	109	75	34				114	69	45			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
AUG	34	30	60	40	323	301	713	463	25	28	52	39	272	289	653	459
SEP	29	27	61	37	288	271	704	426	30	28	53	41	297	258	597	451
OCT	27	27	60	40	267	247	680	463	27	27	52	40	260	249	598	458
NOV	22	20	43	31	273	275	608	481	19	21	41	29	260	287	605	461
DEC	19	19	39	36	307	397	593	489	21	19	43	49	306	318	574	712
1987																
JAN$_{p}$	15	15	44	31	330	404	583	489	14	13	41	29	307	371	569	442
1986 TOTAL	294	296	733	484					287	292	679	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
1 MONTH																
1987	15	15	44	31					14	13	41	29				
1986	14	10	62	29					14	12	58	34				
1985	10	8	56	32					13	8	53	31				
1984	7	9	61	32					8	9	64	33				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES^1	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
AUG	341	52	354	7.0	232.2	105.4	32.4	94.4	1,162	680	482	159	109	50
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	678	476	157	112	45
OCT	326	54	362	6.3	231.6	107.0	32.7	91.9	1,143	675	468	167	117	50
NOV	266	48	358	6.3	230.2	107.1	33.0	90.1	1,125	667	458	148	106	41
DEC	268	49	366	5.9	226.1	107.5	30.2	88.4	1,109	662	447	175	120	55
1987														
JAN$_p$	**215**	**53**	**360**	**6.3**	**225.5**	**108.1**	**32.7**	**84.7**	**1,098**	**664**	**434**	**132**	**88**	**44**
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
1 MONTH														
1987	215	53										132	88	44
1986	213	55										123	82	41
1985	190	48										111	76	35
1984	178	52										112	76	36

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.
1986										
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
JUN	59,859	14,251	21,960	20,140	3,508	45,093	12,963	18,460	13,465	205
JUL	60,720	16,534	21,687	18,946	3,553	47,350	15,860	18,639	12,360	491
AUG$_p$	**60,316**	**14,901**	**21,848**	**20,803**	**2,764**	**44,713**	**13,383**	**18,034**	**12,854**	**442**
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
8 MONTHS										
1986	362,309	88,484	133,617	119,527	20,681	268,914	82,098	109,481	75,054	2,281
1985	221,217	42,705	80,760	74,201	14,551	148,963	39,233	68,313	40,821	596
1984	202,126	36,858	90,347	64,461	10,460	140,746	34,515	68,751	36,941	539
1983	179,373	43,386	66,210	60,976	8,801	132,262	41,034	52,816	37,934	478

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.
1986										
FEB	$2,335	$323	$1,099	$541	$372	$6,888	$186	$1,222	$4,024	$1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,578	489	1,363	508	218	9,420	224	1,474	5,480	2,242
JUN	3,615	1,076	1,580	631	328	11,151	212	1,920	6,044	2,975
JUL	3,034	464	1,345	598	627	10,336	210	1,703	5,988	2,435
AUG$_p$	**3,596**	**862**	**1,711**	**719**	**304**	**12,007**	**656**	**2,103**	**7,230**	**2,018**
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
8 MONTHS										
1986	21,620	4,002	10,881	4,291	2,446	71,775	2,384	13,255	40,182	15,954
1985	15,543	1,502	8,713	4,077	1,251	56,711	1,970	12,734	29,303	12,704
1984	13,634	348	8,611	3,864	811	47,746	1,995	12,985	23,656	9,110
1983	9,729	450	5,209	3,289	781	37,382	1,902	8,185	19,753	7,542

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.
1986										
MAR	$42,995	$14,666	$17,787	$6,118	$4,424	$124,591	$23,110	$50,614	$31,658	$19,209
APR	47,297	12,715	21,823	8,751	4,008	137,439	27,712	53,917	35,037	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,526	24,409	56,406	56,536	23,175
JUN	49,263	12,655	23,179	10,147	3,282	151,012	32,922	56,520	39,551	22,219
JUL	44,931	10,430	23,101	8,853	2,547	137,634	27,902	53,058	36,389	20,285
AUG$_p$	**50,156**	**10,636**	**20,522**	**18,176**	**2,822**	**166,911**	**27,555**	**51,546**	**67,517**	**20,293**
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
8 MONTHS										
1986	355,292	86,634	156,612	84.584	27,462					
1985	205,488	36,530	109,718	38,669	20,571					
1984	182,029	31,837	103,333	33,603	13,256					
1983	169,887	49,409	82,784	25,312	12,382					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA^3	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
NOV	201	101	38	62	191	12,960	112	6,927	32	2,257	47	3,776
DEC	n.a.	n.a.	39	65	n.a.	n.a.	n.a.	n.a.	39	2,768	49	4,014
1987												
JAN$_p$	**n.a.**	**n.a.**	**41**	**47**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**38**	**2,718**	**42**	**3,561**
1986 TOTAL	n.a.	n.a.	452	923	n.a.	n.a.	n.a.	n.a.	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1 MONTH												
1987	n.a.	n.a.	41	47	n.a.	n.a.	n.a.	n.a.	38	2,718	42	3,561
1986	204	130	23	51	110	7,299	45	2,659	19	1,305	46	3,335
1985	140	56	14	70	93	5,973	20	1,125	11	723	62	4,125
1984	131	36	19	76	109	7,017	14	753	24	1,544	71	4,720

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1986										
AUG	3,840	3,800	81,060	7,079	12,722	13,707	10,458	10,127	10,177	6,813
SEP	4,248	4,649	86,359	7,357	10,943	10,658	12,485	13,090	36,333	12,861
OCT	2,375	3,784	89,573	5,535	11,595	9,356	11,566	11,401	9,859	10,221
NOV	1,811	2,549	93,525	5,636	n.a.	n.a.	n.a.	n.a.	13,319	9,612
DEC	1,272	2,336	97,174	5,494	n.a.	n.a.	n.a.	n.a.	10,377	12,123
1987										
JANp	948	1,364	101,887	6,363	n.a.	n.a.	n.a.	n.a.	13,932	10,624
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
1 MONTH										
1987	948	1,364	—	6,363	89,264	90,880	82,306	80,312	13,932	10,624
1986	1,315	1,188	—	3,964	35,615	38,483	34,236	31,671	10,103	5,298
1985	1,300	1,943	—	913	22,669	24,269	15,505	14,158	4,573	2,654
1984	1.772	1,285	—	251	28,064	29,050	19,929	19,117	2,500	2,718

*FHLMC Year-to-date totals are periods Jan.-Oct. 1983-1986.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA	CONVENTIONAL		CONVENTIONAL				
	New[4]	New	Existing	New	Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1986								
SEP	9.90%	9.96%	9.95%	10.17%	10.08%	7.86%	9.588%	12.16%
OCT	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
NOV	9.26	9.47	9.47	9.91	9.84	7.76	9.440	11.54
DEC	9.21	9.33	9.36	9.69	9.65	7.94	8.973	11.09
1987								
JAN	8.79	9.09	9.10	9.51	9.53	8.31	8.815	10.81
FEBp	n.a.	n.a.	n.a.	9.25	9.25	8.48	8.680	10.25

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
SEP	9.28%	9.25%	9.30%	9.56%	7.45%	5.35%	5.68%
OCT	9.05	9.12	9.16	9.48	7.43	5.26	5.68
NOV	8.78	8.91	8.94	9.31	7.25	5.42	5.76
DEC	8.40	8.48	8.50	9.08	7.11	5.53	6.10
1987							
JAN	8.22	8.31	8.26	8.92	7.08	5.44	5.84
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
SEP	34	183	180	185
OCT	49	162	169	173
NOV	18	153	166	169
DEC	29	129	137	139
1987				
JAN	−13	114	123	118
FEB	n.a.	81	96	92

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING

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MORTGAGE BANKING

VOLUME 47 NO. 8
MAY 1987

ARTICLES

PAGE 10
TRAINING: PROVIDING A LEG UP FROM ON THE JOB TRAINING
Jack Davis
A formal training program provides some new approaches to old problems and helps everyone involved become more aware of impending difficulties. This article gives an overview of the characteristics every formal program should have.

PAGE 20
SALES: TEN DOS AND TEN DON'TS
James L. Hennessy, Jr. and James C. Pratt
This article describes several resolutions that can help revitalize a loan originator's career. The most important resolution a person can make is to implement the decision to change.

PAGE 34
ROLLING OUT THE RED CARPET FOR NEW RECRUITS
John L. Jansen
Isn't it remarkable that a profession as established as mortgage banking cannot attract more college graduates? Lenders would rather train people from related professions or hire away experienced practitioners. This author believes that mortgage lending human resources departments need to become more resourceful.

PAGE 43
THE EXPANSION OF COINSURANCE PROGRAMS
Gaye Beasley
The mortgage banking companies that are approved for the 223(f) program have refinanced or provided acquisition loans for more than $3.4 billion in project loans for 570 properties. Read about the various programs in this article.

PAGE 53
A LENDER'S GUIDE TO ENVIRONMENTAL LIABILITY RISK MANAGEMENT
Joseph Philip Forte
Real estate professionals—developers, owners and lenders alike need to become aware of their potential exposure to liability for toxic waste. This practical guide offers some suggestions for the mortgage banking community.

PAGE 67
BUSINESS BASICS
MBSs MADE SIMPLE
Larry Kirschner
Mortgage-backed securities can be a lucrative deal for investors. This article explains the advantages and risks involved in investing in these securities.

PAGE 81
REO: A PRE-FORECLOSURE COUNSELING SOLUTION
Michael R. Massa
A buyer who cannot make the mortgage payments is better off to market the property than walking off and abandoning the property. Pre-foreclosure programs help provide an alternative for the homeowner, lender and mortgage insurer.

PAGE 93
RELOCATION: RELIEVING THE BULK OF THE BURDEN
Mike Harris
The financial services industry has gone to bat for the two-income family. Mortgage lenders are developing customized relocation home loan programs.

PAGE 99
THE LAST WORD (LEGAL PITFALLS LENDERS ENCOUNTER IN CALIFORNIA)
Alexis A. Fafenrodt
This article deals with the legal pitfalls that institutional lenders may encounter in California.

DEPARTMENTS

ABOUT THE ISSUE 3
BUSINESS BASICS 67
PEOPLE 108
BOOKS 120
SECONDARY MORTGAGE MARKETS 123
MORTGAGE MARKET TRENDS 125
AD INDEX 134

MORTGAGE MARKET TRENDS

Long-term interest rates had been remarkably stable for most of the first three months of this year. Yields on 10-year Treasury bonds fluctuated within a very narrow range around 7¼ percent. Then, during the last week of March and the first week of April long-term rates increased sharply—up about 40 basis points. While interest rates have retreated somewhat recently, there is some concern that the financial market developments of late March and early April signal the beginning of a significant rise in interest rates in the months ahead. MBA economists believe that while interest rates are at or near their trough for the current business cycle, they are most likely to remain near current levels for the remainder of this year.

The recent runup of interest rates was largely in response to international developments. The dollar's continued fall in exchange markets since early this year renewed fears in credit markets that foreign sources of capital might be frightened away, and that the Federal Reserve might be forced to tighten monetary policy as a means of restoring confidence in the currency.

Domestic economic developments were also a contributing factor. Employment gains in January and February were quite strong, suggesting that the economy may be breaking out of the lethargic growth path it has been in since mid-1984. Moreover, both consumer prices and prices of finished producer goods rose faster in January and February than they had been in 1986.

MBA economic analysis of underlying developments does not, however, suggest a serious threat of a fundamental worsening of inflation, mainly because economic growth is likely to remain quite moderate. Although first quarter gross national product (GNP) growth was apparently in the 3 to 3½ percent range at an annual rate, and thus well above the 1.1 percent growth pace of the fourth quarter of last year, the principal source of this growth was a sharp turnaround in non-farm inventory investment. Aside from inventory investment, the economy remained weak. Real personal consumption expenditures—the largest component of GNP—likely declined during the first quarter, reflecting lower auto sales. Data on construction outlays and shipments of non-defense capital goods suggest that real business fixed investment also declined. Residential investment may have increased somewhat during the first quarter due to a rise in single-family housing starts, but this stimulus to growth was not large.

Indeed, more recent indicators support this view. In March, total employment at non-farm establishments rose just 164,000 while the number of jobs in the manufacturing sector fell by 24,000. This suggests that part of the first quarter inventory buildup was involuntary and will be followed by a more moderate rate of accumulation this quarter. Consequently, real GNP growth in the second quarter is expected to dip below a 2 percent annual rate.

During the four quarters of 1987, real GNP is expected to rise a bit more than 2½ percent—a stronger growth rate than in 1986, but generally in line with the average since mid-1984. Continued moderate real growth is also expected to limit increases in wages and costs this year, and thus help ward off the threat of a serious worsening of inflation. Nonetheless, with oil prices back to the $17 range, and with import prices rising somewhat more rapidly, consumer prices are expected to increase about 4 percent in 1987, compared with less than 2 percent in 1986.

While credit markets will probably be buffeted periodically during 1987 by worries about the dollar's international value, continuation of moderate economic growth and the avoidance of a fundamental worsening of inflation will be a calming influence. Thus, interest rates are likely to remain near current levels for the remainder of this year.

This expectation, if realized, would be favorable for housing markets. In the one- to four-family area, the strength of starts early this year partly reflected favorable winter weather in some parts of the country and the effects of the decline in mortgage interest rates since last fall. Just as they did in 1986, single-family starts are likely to decline modestly in an environment of stable mortgage interest rates. Even so, for the year as a whole, single-family starts in 1987 are expected to be equal to, or slightly above, their 1986 level. In the multifamily area, the contribution of high vacancy rates and tax reform is expected to reduce starts to around a 400,000 annual rate before year-end.

Richard W. Peach
Senior Economist
April 8, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
SEP	154	108	46	1,689	1,185	504	152	103	49	1,603	1,144	459
OCT	155	109	46	1,657	1,199	458	146	103	43	1,565	1,109	456
NOV	116	83	33	1,637	1,200	437	109	72	37	1,613	1,083	530
DEC	114	80	34	1,808	1,334	474	132	82	50	1,910	1,282	628
1987												
JAN	104	74	30	1,804	1,323	481	99	68	31	1,690	1,186	504
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1986 TOTAL	1,806	1,263	543				1,762	1,186	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
2 MONTHS												
1987	207	150	57				199	144	55			
1986	223	150	73				228	142	86			
1985	200	134	66				205	127	78			
1984	239	164	75				243	152	91			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
SEP	29	27	61	37	288	271	704	426	30	28	53	41	297	258	597	451
OCT	27	27	60	40	267	247	680	463	27	27	52	40	260	249	598	458
NOV	22	20	43	31	273	275	608	481	19	21	41	29	260	287	605	461
DEC	19	19	39	36	307	397	593	489	21	19	43	49	306	318	574	712
1987																
JAN	15	16	43	30	319	420	585	480	14	14	41	29	294	389	570	437
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1986 TOTAL	294	296	733	484					287	292	679	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
2 MONTHS																
1987	24	30	88	65					29	30	84	56				
1986	27	21	113	63					27	24	111	66				
1985	17	14	106	63					24	15	103	64				
1984	16	20	138	65					18	21	133	70				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	678	476	157	112	45
OCT	326	54	362	6.3	231.3	106.9	32.6	91.8	1,143	675	468	167	117	50
NOV	266	48	358	6.3	230.6	107.1	33.1	90.4	1,125	667	458	148	106	41
DEC	268	49	366	5.9	226.2	107.5	30.3	88.4	1,104	658	446	175	120	55
1987														
JAN	215	52	358	6.4	220.8	108.1	31.1	81.6	1,088	657	430	137	91	46
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
2 MONTHS														
1987	456	106										251	167	84
1986	430	114										240	158	83
1985	386	98										240	163	77
1984	380	110										221	153	68

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	60,720	16,534	21,687	18,946	3,553	47,350	15,860	18,639	12,360	491
AUG	60,316	14,901	21,848	20,803	2,764	44,713	13,383	18,034	12,854	442
SEP	58,193	14,360	20,289	20,576	2,968	42,621	12,648	16,668	12,870	435
OCT	56,285	12,659	20,760	19,781	3,085	41,901	11,535	16,992	12,985	389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
12 MONTHS										
1986	362,309	88,484	133,617	119,527	20,681	438,441	131,628	176,063	126,936	3,814
1985	221,217	42,705	89,760	74,201	14,551	242,112	63,296	109,286	68,224	1,306
1984	202,126	36,858	90,347	64,461	10,460	199,228	47,589	96,187	54,626	826
1983	179,373	43,386	66,210	60,976	8,801	197,527	59,672	81,524	55,605	726

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$3,034	$464	$1,345	$598	$627	$10,336	$210	$1,703	$5,988	$2,435
AUG	3,596	862	1,711	719	304	12,007	656	2,103	7,230	2,018
SEP	4,769	1,326	1,897	1,312	234	10,803	386	1,724	6,394	2,229
OCT	3,560	735	1,933	735	157	10,824	389	1,835	6,061	2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
12 MONTHS										
1986	39,363	7,172	19,877	8,591	3,723	126,134	4,084	22,168	69,976	29,906
1985	28,392	2,746	15,612	7,262	2,772	99,941	3,114	20,485	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$45,221	$10,430	$23,101	$8,853	$2,837	$137,634	$27,902	$53,058	$36,389	$20,285
AUG	50,492	10,930	20,522	16,183	2,857	167,546	28,195	51,546	67,517	20,293
SEP	48,050	11,297	19,442	15,024	2,287	159,746	25,320	51,957	62,601	19,868
OCT	43,470	8,959	19,202	12,593	2,716	138,410	17,784	49,878	51,605	19,143
NOV	35,692	8,263	17,111	7,554	2,764	129,766	20,974	48,994	40,726	19,072
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
12 MONTHS										
1986	527,397	128,480	231,915	127,902	39,100					
1985	324,089	59,551	170,755	61,311	32,472					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
NOV	201	101	38	62	191	12,960	112	6,927	32	2,257	47	3,776
DEC	215	111	39	65	176	12,313	88	5,531	39	2,768	49	4,014
1987												
JAN	208	120	41	47	175	12,143	95	5,864	38	2,718	42	3,561
1986 TOTAL	3,283	1,908	452	923	1,770	122,474	839	51,616	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
2 MONTHS												
1987	451	273	83	95	n.a.	n.a.	n.a.	n.a.	82	5,973	75	6,373
1986	416	266	49	101	207	13,892	90	5,432	37	2,546	80	5,914
1985	215	49	30	136	166	10,760	30	1,704	24	1,590	112	7,466
1984	244	53	36	155	210	13,484	34	1,846	66	2,993	129	8,645

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
SEP	4,248	4,649	86,359	7,357	10,943	10,658	12,485	13,090	36,333	12,861
OCT	2,375	3,784	89,573	5,535	11,595	9,356	11,566	11,401	9,859	10,221
NOV	1,811	2,549	93,525	5,636	8,926	9,356	9,862	10,540	13,319	9,612
DEC	1,272	2,336	97,174	5,494	n.a.	n.a.	n.a.	n.a.	10,377	12,123
1987										
JAN	948	1,364	101,687	6,363	n.a.	n.a.	n.a.	n.a.	13,932	10,624
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
2 MONTHS										
1987	1,860	2,343	—	11,054	98,190	100,236	92,186	90,852	25,600	20,316
1986	3,893	2,347	—	6,942	41,009	43,337	37,917	35,119	16,076	10,304
1985	3,195	3,502	—	2,733	26,968	28,427	17,747	16,171	8,755	5,354
1984	3,702	2,792	—	1,377	29,660	31,143	21,216	20,256	6,922	5,748

*FHLMC Year-to-date totals are periods Jan.-Nov. 1983-1986.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
OCT	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
NOV	9.26	9.47	9.47	9.91	9.84	7.76	9.440	11.54
DEC	9.21	9.33	9.36	9.69	9.65	7.94	8.973	11.09
1987								
JAN	8.79	9.09	9.10	9.51	9.53	8.31	8.815	10.81
FEB	8.81	9.04	9.04	9.23	9.21	8.48	8.668	10.25

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS: GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES: A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
OCT	9.05%	9.12%	9.16%	9.48%	7.43%	5.26%	5.68%
NOV	8.78	8.91	8.94	9.31	7.25	5.42	5.76
DEC	8.40	8.48	8.50	9.08	7.11	5.53	6.10
1987							
JAN	8.22	8.31	8.26	8.92	7.08	5.44	5.84
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
OCT	49	162	169	173
NOV	18	153	166	169
DEC	29	129	137	139
1987				
JAN	−13	114	123	118
FEB	−3	81	96	92

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING

JUNE 1987

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6/15/87

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MORTGAGE BANKING

VOLUME 47 NO. 9
JUNE 1987

ARTICLES

PAGE 8
AUTOMATION: CUTTING TIME, ERRORS AND COSTS
Vic Lanzillotti and Eugene Bonte
This article provides an economic framework for understanding the benefits of automation, one component of internal management. It is based on the industry's relatively recent success with fully automating the loan production cycle. Automation can mean profits in time and money.

PAGE 21
REGULATORY COMPLIANCE TRAINING: BRIDGING THE GAP
Helen Bishop
It is time for frontline personnel to receive better training on the subject of regulatory compliance. This article describes programs that have attempted to enhance awareness and observance of regulatory compliance and makes recommendations for proper training materials.

PAGE 30
ON THE WATCH WITH AUTOMATED FORECLOSURE SYSTEMS
Amy K. Losi
Goldome Realty Credit Corp. took a proactive stance to reduce potential risk of foreclosures by implementing an automated tracking system. This article describes how this system was developed and some of its results.

PAGE 40
DRAFTING THE WORLD SERIES TEAM
William H. Evans and Jeffry L. Baker
This article describes how a company can do 70 percent better as a team than with individuals. It suggests some ways to assess how well your team is doing. This author believes that the total is greater than the sum of the parts.

PAGE 51
GO PRIVATE: FANNIE MAY?
David O. Maxwell
HUD has given Fannie Mae the approval to issue REMICs but is has also asked Fannie to develop a proposal for privatizing itself. Chairman Maxwell outlines Fannie Mae's concerns and industry considerations in this article.

PAGE 61
STRIPPED MORTGAGE-BACKED SECURITIES: THE SUM IS GREATER THAN THE PARTS
Patricia M. Sherlock and Le In Chen
Mortgage strips are formed by the partition of the distributions of principal and interest in the underlying collateral from a pro rata basis to a variable allocation. This article explains how strips offer an alternative that can be sold to the secondary market.

PAGE 73
BUSINESS BASICS HOW TO PROPERLY INTRODUCE A LOAN ORIGINATOR
Joseph Dans
This article outlines a successful way to introduce a new loan officer to a territory. A company needs to use proper sales planning and a common sense marketing approach.

PAGE 87
SENIOR/SUBORDINATED PRODUCTS: BEYOND TRADITIONAL MORTGAGE SECURITIES
Barbara G. Novick and Bruce G. Sabath
Traditional obstacles that have kept many mortgage banking institutions from participating in the securities market are being overcome and eliminated. Major product innovations are providing the incentives to issue and invest in mortgage-related securities. This article gives details on First Boston's passthrough security.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 73
PEOPLE 100
SECONDARY MORTGAGE MARKET 107
MORTGAGE MARKET TRENDS 109
AD INDEX 118

MORTGAGE MARKET TRENDS

Preliminary Department of Commerce estimates indicate that real GNP grew at a 4.3 percent annual rate in the first quarter of this year following a 1.1 percent increase during the final quarter of 1986. A sharp turnaround in non-farm inventory investment accounted for virtually all the quarterly gain in real GNP. In addition, the foreign trade sector also posted its second consecutive quarterly contribution to overall growth. However, all of the other components of GNP—personal consumption, business fixed investment residential investment and government purchases—declined in real terms during the January through March period.

The pace of inventory investment appears to be subsiding dramatically from first quarter levels, due to reduced auto production. Consequently, during the second quarter GNP will probably expand at less than a 2 percent annual rate. However, during the second half of this year, increases in consumer spending and business fixed investment, as well as further improvement in the trade sector, should allow for a moderate pick-up in growth, to an annual rate in the 2 to 2 1/2 percent range.

During the first quarter, personal consumption expenditures declined due to a sharp drop off in auto sales. Business fixed investment declined 13 percent, resulting in large measure from a further decline in new building construction. Although tax reform had an impact on the timing and magnitude of the drop, the high level of vacancy rates in commercial buildings will restrict activity in this area for some time to come. Producer's purchases of durable equipment also fell in the first quarter, but should begin to show modest improvement in the months ahead.

Residential fixed investment also posted a decline in the first quarter, down more than 7 percent from the fourth quarter level. While housing starts averaged 1.8 million units at an annual rate during the first quarter, up from 1.7 million during the fourth quarter, the level of starts had been declining throughout 1986, resulting in declining levels of residential building activity. Reductions in both single-family and multifamily housing starts are expected during the remainder of this year, particularly in view of the recent runup in interest rates. Housing starts should total 1,650,000 units for all of 1987, compared to 1.8 million units in 1986.

For the second consecutive quarter, real net exports added to GNP growth as the benefits of the dollar's decline in foreign exchange markets begin to be realized. Real net exports rose during the quarter because imports declined at a rate substantially faster than did exports. Although a portion of this improvement reflected a drop in oil imports, which are likely to increase in the months ahead, there was further improvement in the balance between non-farm exports and non-oil imports.

Prices rose somewhat faster during the first quarter than in 1986, but the outlook for inflation still remains reasonably optimistic. The Consumer Price Index rose at a 5.3 percent annual rate in the first quarter, up sharply from 2.9 percent in the fourth quarter. Higher oil prices and the declining dollar, which boosted import prices, were the major factors behind this increase in inflation. However, continued moderate increases in domestic wages and intense price competition should keep the overall inflation rate at about 4 1/2 percent for all of 1987.

Interest rates, and particularly long-term rates, have increased dramatically since March in response to developments in foreign exchange markets. A substantial decline in the dollar's value generated fears in credit markets of a withdrawal of foreign capital from the U.S., a worsening of inflation and a tightening of monetary policy. However, given the current economic fundamentals—modest growth of the economy and moderate wage gains—these fears appear to be exaggerated. Therefore, some retreat from the recent increases in rates is possible but it is unlikely that mortgage rates will drop below 10 percent again this year.

Gregory D. Luetscher
Economist

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
OCT	155	109	46	1,657	1,199	458	146	103	43	1,565	1,109	456
NOV	116	83	33	1,637	1,200	437	109	72	37	1,613	1,083	530
DEC	114	80	34	1,808	1,334	474	132	82	50	1,910	1,282	628
1987												
JAN	105	75	30	1,816	1,332	484	98	67	31	1,690	1,186	504
FEB	102	77	26	1,833	1,373	460	101	76	25	1,763	1,346	417
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1986 TOTAL	1,806	1,263	543				1,762	1,186	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
3 MONTHS												
1987	350	259	91				352	254	98			
1986	374	254	120				381	240	141			
1985	346	236	110				349	224	125			
1984	377	264	113				397	256	141			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
OCT	27	27	60	40	267	247	680	463	27	27	52	40	260	249	598	458
NOV	22	20	43	31	273	275	608	481	19	21	41	29	260	287	605	461
DEC	19	19	39	36	307	397	593	489	21	19	43	49	306	318	574	712
1987																
JAN	16	16	44	29	336	431	589	460	14	14	41	29	294	389	570	437
FEB	9	14	44	34	278	381	664	510	15	16	43	27	355	403	601	404
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
1986 TOTAL	294	296	733	484					287	292	679	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
3 MONTHS																
1987	46	54	146	104					54	56	144	98				
1986	47	42	182	103					47	44	178	113				
1985	33	32	181	100					44	32	170	104				
1984	27	35	215	101					33	36	214	114				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
OCT	326	54	362	6.3	231.3	106.9	32.6	91.8	1,143	675	468	167	117	50
NOV	266	48	358	6.2	230.6	107.1	33.1	90.4	1,125	667	458	148	106	41
DEC	268	49	366	5.8	226.2	107.5	30.3	88.4	1,104	658	446	175	120	55
1987														
JAN	216	53	355	6.3	225.1	108.4	31.1	85.6	1,089	658	431	137	91	46
FEB	241	58	349	6.3	229.0	109.6	29.5	89.9	1,097	670	427	118	78	40
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
3 MONTHS														
1987	785	179										380	253	127
1986	708	203										373	250	123
1985	645	170										365	247	118
1984	643	173										341	235	106

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$60,720	$16,534	$21,687	$18,946	$3,553	$47,350	$15,860	$18,639	$12,360	$491
AUG	60,316	14,901	21,848	20,803	2,764	44,713	13,383	18,034	12,854	442
SEP	58,193	14,360	20,289	20,576	2,968	42,621	12,648	16,668	12,870	435
OCT	56,285	12,659	20,760	19,781	3,085	41,901	11,535	16,992	12,985	389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
12 MONTHS										
1986	362,309	88,484	133,617	119,527	20,681	438,441	131,628	176,063	126,936	3,814
1985	221,217	42,705	89,760	74,201	14,551	242,112	63,296	109,286	68,224	1,306
1984	202,126	36,858	90,347	64,461	10,460	199,228	47,589	96,187	54,626	826
1983	179,373	43,386	66,210	60,976	8,801	197,527	59,672	81,524	55,605	726

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	5+ UNITS Mtg. Bankers[9]	5+ UNITS S&Ls	5+ UNITS Banks[2]	5+ UNITS Life Cos.	NONRESIDENTIAL Total	NONRESIDENTIAL Mtg. Bankers[9]	NONRESIDENTIAL S&Ls	NONRESIDENTIAL Banks[2]	NONRESIDENTIAL Life Cos.
1986										
JUL	$3,034	$464	$1,345	$598	$627	$10,336	$210	$1,703	$5,988	$2,435
AUG	3,596	862	1,711	719	304	12,007	656	2,103	7,230	2,018
SEP	4,769	1,326	1,897	1,312	234	10,803	386	1,724	6,394	2,229
OCT	3,560	735	1,933	735	157	10,824	389	1,835	6,061	2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
12 MONTHS										
1986	39,363	7,172	19,877	8,591	3,723	126,134	4,084	22,168	69,976	29,906
1985	28,392	2,746	15,612	7,262	2,772	99,941	3,114	20,485	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	ISSUED DURING MONTH Mtg. Bankers[9]	ISSUED DURING MONTH S&Ls	ISSUED DURING MONTH Banks[2]	ISSUED DURING MONTH Life Cos.	OUTSTANDING Total	OUTSTANDING Mtg. Bankers[9]	OUTSTANDING S&Ls	OUTSTANDING Banks[2]	OUTSTANDING Life Cos.
1986										
JUL	$45,221	$10,430	$23,101	$8,853	$2,837	$137,634	$27,902	$53,058	$36,389	$20,285
AUG	50,492	10,930	20,522	16,183	2,857	167,546	28,195	51,546	67,517	20,293
SEP	48,050	11,297	19,442	15,024	2,287	159,746	25,320	51,957	62,601	19,868
OCT	43,470	8,959	19,202	12,593	2,716	138,410	17,784	49,878	51,605	19,143
NOV	35,692	8,263	17,111	7,554	2,764	129,766	20,974	48,994	40,726	19,072
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
12 MONTHS										
1986	527,397	128,480	231,915	127,902	39,100					
1985	324,089	59,551	170,755	61,311	32,472					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
OCT	249	128	38	83	162	$11,293	75	$4,556	28	$2,024	59	$4,713
NOV	201	101	38	62	191	12,960	112	6,927	32	2,257	47	3,776
DEC	215	111	39	65	176	12,313	88	5,531	39	2,768	49	4,014
1987												
JAN	208	120	41	47	175	12,143	95	5,864	38	2,718	42	3,561
FEB	243	153	42	48	n.a.	n.a.	n.a.	n.a.	44	3,255	33	2,812
1986 TOTAL	3,283	1,908	452	923	1,770	122,474	839	51,616	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
3 MONTHS												
1987	296	n.a.	132	164	n.a.	n.a.	n.a.	n.a.	142	10,393	114	9,712
1986	720	477	81	162	324	21,926	149	9,189	60	4,169	115	8,568
1985	447	179	46	222	258	16,584	58	3,208	37	2,416	163	10,960
1984	450	129	55	266	336	21,197	70	3,653	65	4,194	201	13,350

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1986										
OCT	$2,375	$3,784	$89,573	$5,535	$11,595	$9,356	$11,566	$11,401	$9,859	$10,221
NOV	1,811	2,549	93,525	5,636	8,926	9,356	9,862	10,540	13,319	9,612
DEC	1,272	2,336	97,174	5,494	7,993	8,742	11,306	11,579	10,377	12,123
1987										
JAN	948	1,364	101,687	6,363	n.a.	n.a.	n.a.	n.a.	13,932	10,624
FEB	912	979	104,670	4,691	n.a.	n.a.	n.a.	n.a.	11,668	9,692
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
3 MONTHS										
1987	4,528	3,759	—	15,681	n.a.	n.a.	n.a.	n.a.	36,473	31,052
1986	5,810	3,757	—	9,020	106,563	136,179	103,474	102,433	30,929	15,362
1985	4,830	5,758	—	3,820	44,025	56,689	44,012	41,454	12,511	8,126
1984	5,328	4,822	—	3,783	30,743	34,737	21,885	20,489	10,005	8,235

*FHLMC Year to date totals are periods Jan.-Dec. 1984-1986.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA New[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1986								
NOV	9.26%	9.47%	9.47%	9.91%	9.84%	7.76%	9.440%	11.54%
DEC	9.21	9.33	9.36	9.69	9.65	7.94	8.973	11.09
1987								
JAN	8.79	9.09	9.10	9.51	9.53	8.31	8.815	10.81
FEB	8.81	9.04	9.04	9.23	9.21	8.48	8.668	10.25
MAR	8.94	9.19	9.20	9.14	9.09	8.06	8.633	10.24

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
NOV	8.78%	8.91%	8.94%	9.31%	7.25%	5.42%	5.76%
DEC	8.40	8.48	8.50	9.08	7.11	5.53	6.10
1987							
JAN	8.22	8.31	8.26	8.92	7.08	5.44	5.84
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05
MAR	8.12	8.25	8.22	8.84	7.25	5.59	6.16

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
NOV	18	153	166	169
DEC	29	129	137	139
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MAR	10	87	100	97

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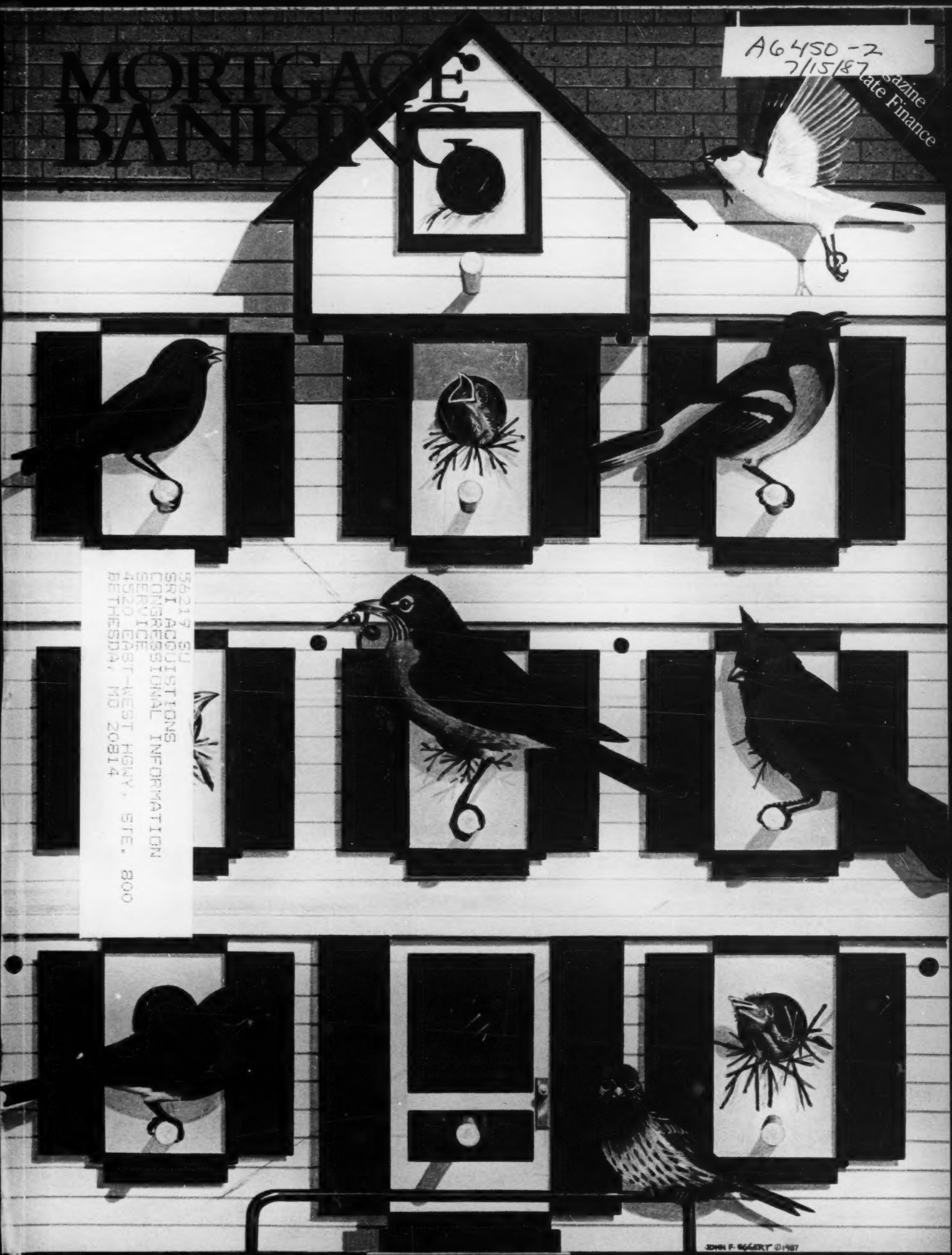

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VOLUME 47 NO. 10
JULY 1987

ARTICLES

PAGE 8
MLP: THE LEADING MULTIFAMILY FINANCE VEHICLE
Sheldon L. Schreiberg
This article describes how and why master limited partnerships are becoming the dominant force in multifamily finance for the rest of this decade. Profiles of different MLPs are provided.

PAGE 18
RENTAL RETIREMENT HOMES: HOW WILL THE MARKET FARE?
David S. Beckerman
Current trends in the residential mortgage industry may dampen future demand for rental retirement housing. Depletion of home equity will cause affordability of rental retirement housing to drop.

PAGE 26
FEDERALLY-ASSISTED HOUSING: NOW YOU SEE IT, SOON YOU WON'T?
John K. McIlwain and
Patrice M. Pitts
The availability of low-income housing may overshadow affordability as the leading low-income housing problem. During the next 20 years, the combination of expiring federal rent subsidies and the prepayment of mortgages on these types of properties could drastically reduce inventories, according to these authors.

PAGE 38
CONSTRUCTION LOANS: LENDERS BEWARE
Henry S. Kesler, CMB
To successfully navigate the inherent risks of construction lending, the loan decisions must be based on sound and thorough underwriting and aggressive administration policies and procedures. According to this author, construction lending is never over until it is over.

PAGE 45
FANNIE MAE'S MAJORS ENTER THE BIG LEAGUE
Robert J. Levin
Fannie Majors allow lenders to include their current production mortgages in a pool with other lenders' loans. If a lender contributes $4 million in mortgages to a Fannie Major, the lender will receive a $4 million share of that pool. Learn how multi-lender MBSs have advantages for investors, dealers and lenders alike.

PAGE 53
ONE STOP SHOPPING GUIDE TO MORTGAGE PROTECTION INSURANCE
Diane Gates
This article offers mortgage bankers a guide to mortgage protection service. It traces the history of mortgage protection service and details the different types of coverage available. It even offers suggestions on how to select a carrier.

PAGE 65
LENDERS' STRATEGIES FOR ENVIRONMENTAL LIABILITY
David Slutzky
Lenders have clearly been placed in a position of vulnerability by the Superfund Act. This article explains how to develop a policy to protect lenders from economic disaster due to contaminated sites.

PAGE 77
ASBESTOS: DEALING WITH AN EMOTIONAL ISSUE
Christine Boylan Carr
The heart of a lender's concern is not only the liability of a building containing asbestos but the value of the asset. Fixed-rate, long-term financing is available for buildings containing asbestos but only on a very select basis.

PAGE 81
BUSINESS BASICS
SOURCES OF FINANCING FOR CONGREGATE HOUSING
Arthur A. Habighorst and
John D. Hirschfeld
This article details important considerations investors should know about insured sources of financing for congregate housing. FAA insurance provides the guarantees necessary to attract investor capital for retirement service centers.

PAGE 89
CONSTRUCTION LENDING: TODAY AND TOMORROW
This Round Table discussion was adapted from a popular panel held at the 1987 MBA Income Property Conference. Panelists discuss construction risks and methods for lessening those risks.

PAGE 101
THE LAST WORD (IF IT AIN'T BROKE, DON'T FIX IT)
Bill Sinclair
This thrift executive believes that neither the market nor the future of Fannie Mae and Freddie Mac should be dictated by a select few who are concerned about their own increased profit or gain at the expense of many.

DEPARTMENTS

ABOUT THE ISSUE 5
BUSINESS BASICS 81
PEOPLE 106
BOOKS 112
LETTERS 112
SECONDARY MORTGAGE MARKETS 115
MORTGAGE MARKET TRENDS 117
AD INDEX 126

MORTGAGE MARKET TRENDS

For the first quarter of 1987, the economy expanded at a robust annual rate of 4.4 percent. However, attention should be focused more on the composition rather than the magnitude of this gain. Growth was concentrated in only two areas—a substantial rise in inventory investment and a significant improvement in real net exports. All other components of GNP declined during the quarter. Efforts to control inventories, combined with the run-up in interest rates in April and May, suggest that growth of the economy during the second quarter was most likely very sluggish and should remain so during the third quarter. For both quarters, increases in real GNP should range between 1 and 2 percent.

In the first quarter, the single most important source of strength was a $63 billion swing in business inventories, much of which was concentrated in automobiles. Auto production was cut in March and again in April, but production is now about even with sales so that excess inventories have yet to be reduced. Thus, further auto production cuts are likely as are additional or extended sales incentives. Other industrial sectors have also been reducing production during March and April.

The other significant source of growth in real GNP during the first quarter was the improvement in real net exports of goods and services. Imports decreased by $6.2 billion while exports increased by $4.6 billion, both in real terms. This resulted in an increase in real net exports of $10.8 billion, the second consecutive quarter of improvement. This turnabout is the result of the steady decline in the dollar during the past two plus years, which has caused import prices to rise while giving U.S. exporters an opportunity to compete more aggressively in world markets. Continued improvement is expected during the rest of this year and 1988.

All the other components of GNP declined during the first quarter. Personal consumption expenditures fell for the second consecutive quarter. In both quarters, the declines occurred in durable goods purchases, primarily autos. This softness in consumer spending appears to be carrying over into the second quarter. In April, retail sales were up only slightly, and in May they fell by 0.6 percent.

Both components of non-residential fixed investment, structures and producers durable equipment, declined sharply in the first quarter. Spending on new structures is expected to continue to fall because of adverse changes in the tax code and the prevailing high vacancy rates for income property. On the other hand, modest improvement in investment in producers durable equipment is expected during the remainder of this year.

Residential construction expenditures have continued the decline which began in the first quarter. In April, building permits fell by 7 percent, with the decline encompassing both single-family and multi-family units. Moreover, the recent jump in mortgage rates suggests that further weakness in this area lies ahead.

Inflation took a sudden jump during the first quarter, which contributed to the turmoil in financial markets. The Consumer Price Index rose at an annual rate of 5.3 percent in the first quarter compared to 2.9 percent during the final quarter of 1986. This advance in the rate of inflation is due primarily to the increase in oil prices in late 1986. The falling dollar has also contributed to the increase in inflation by putting upward pressure on import prices and allowing domestic producers to raise prices as well. However, with increases in wage rates expected to remain moderate and with oil prices beginning to stabilize, inflation is expected to subside somewhat in the coming months. For example, in May the Producer Price Index increased 0.3 percent compared to 0.7 percent in April.

The spike in interest rates that began at the end of March seems to be directly related to this increase in actual inflation which has renewed inflationary expectations. While they have recently retreated somewhat, long-term interest rates remain significantly above the levels that prevailed just two months ago. At the time of this writing (early June) yields on conventional 30-year fixed-rate mortgages are in the 10½ to 10¾ percent range. In light of the weakened state of the economy and the expected subsiding of inflation, mortgage interest rates may edge lower in the weeks ahead and then stabilize for the remainder of the year. However, if the dollar should fall sharply again, another increase in interest rates is not out of the question.

Slow overall economic growth and the recent increase in interest rates are expected to have a slightly negative effect on the housing market. Ultimately, the increased cost of mortgage credit will cause both home sales and then starts to decline from their present levels. By the end of the summer, 1- to 4-family housing starts may drop to an annual rate of 1.1 million units.

Robert Rosenblatt
Assistant Economist
June 11, 1987

HOUSING ACTIVITY
RESIDENTIAL STRUCTURES, BY UNIT TYPE
(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
NOV	116	83	33	1,637	1,200	437	109	72	37	1,667	1,122	545
DEC	114	80	34	1,813	1,341	472	132	82	50	1,862	1,289	573
1987												
JAN	105	75	30	1,816	1,332	484	102	69	33	1,652	1,181	471
FEB	103	76	27	1,838	1,379	459	101	76	25	1,676	1,313	363
MAR	143	109	34	1,749	1,311	438	150	109	41	1,719	1,244	475
1986 TOTAL	1,806	1,263	543				1,769	1,185	584			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
4 MONTHS												
1987	514	387	127				512	373	139			
1986	562	380	182				564	365	199			
1985	522	355	167				518	332	186			
1984	549	384	165				558	362	196			

RESIDENTIAL STRUCTURES BY REGION
(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
NOV	22	20	43	31	273	275	608	481	19	21	41	29	267	300	613	487
DEC	19	19	39	36	309	394	602	508	21	19	43	49	284	303	567	708
1987																
JAN	16	16	44	29	336	431	589	460	14	14	41	29	286	362	568	436
FEB	10	14	45	34	291	371	675	501	15	16	43	27	319	388	577	392
MAR	22	24	56	41	296	356	615	482	25	26	60	41	317	335	624	443
1986 TOTAL	294	296	733	484					283	290	687	510				
1985 TOTAL	252	240	782	468					260	237	753	484				
4MONTHS																
1987	74	82	212	146					80	87	203	141				
1986	76	74	257	154					75	77	250	163				
1985	59	54	261	148					70	55	243	150				
1984	44	56	303	146					51	57	293	157				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
NOV	266	48	353	6.2	230.6	107.1	33.1	90.4	1,125	667	458	148	106	41
DEC	268	49	357	5.8	226.2	107.5	30.3	88.4	1,104	658	446	175	120	55
1987														
JAN	216	53	358	6.2	225.1	108.4	31.1	85.6	1,089	658	431	137	91	46
FEB	241	59	358	6.1	229.4	109.7	29.4	90.3	1,096	669	427	118	78	40
MAR	325	71	357	6.0	227.2	111.5	28.6	87.1	1,085	669	416	127	86	41
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
4 MONTHS														
1987	1,121	260										516	348	168
1986	1,044	288										503	345	158
1985	928	231										492	338	154
1984	912	234										435	290	145

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$60,720	$16,534	$21,687	$18,946	$3,553	$47,350	$15,860	$18,639	$12,360	$491
AUG	60,316	14,901	21,848	20,803	2,764	44,713	13,383	18,034	12,854	442
SEP	58,193	14,360	20,289	20,576	2,968	42,621	12,648	16,668	12,870	435
OCT	56,285	12,659	20,760	19,781	3,085	41,901	11,535	16,992	12,985	389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
12 MONTHS										
1986	362,309	88,484	133,617	119,527	20,681	438,441	131,628	176,063	126,936	3,814
1985	221,217	42,705	89,760	74,201	14,551	242,112	63,296	109,286	68,224	1,306
1984	202,126	36,858	90,347	64,461	10,460	199,228	47,589	96,187	54,626	826
1983	179,373	43,386	66,210	60,976	8,801	197,527	59,672	81,524	55,605	726

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$3,034	$464	$1,345	$598	$627	$10,336	$210	$1,703	$5,988	$2,435
AUG	3,596	862	1,711	719	304	12,007	656	2,103	7,230	2,018
SEP	4,769	1,326	1,897	1,312	234	10,803	386	1,724	6,394	2,229
OCT	3,560	735	1,933	735	157	10,824	389	1,835	6,061	2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
12 MONTHS										
1986	39,363	7,172	19,877	8,591	3,723	126,134	4,084	22,168	69,976	29,906
1985	28,392	2,746	15,612	7,262	2,772	99,941	3,114	20,485	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$45,221	$10,430	$23,101	$8,853	$2,837	$137,634	$27,902	$53,058	$36,389	$20,285
AUG	50,492	10,930	20,522	16,183	2,857	167,546	28,195	51,546	67,517	20,293
SEP	48,050	11,297	19,442	15,024	2,287	159,746	25,320	51,957	62,601	19,868
OCT	43,470	8,959	19,202	12,593	2,716	138,410	17,784	49,878	51,605	19,143
NOV	35,692	8,263	17,111	7,554	2,764	129,766	20,974	48,994	40,726	19,072
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
12 MONTHS										
1986	527,397	128,480	231,915	127,902	39,100					
1985	324,089	59,551	170,755	61,311	32,472					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
OCT	249	128	38	83	162	$11,293	75	$4,556	28	$2,024	59	$4,713
NOV	201	101	38	62	191	12,960	112	6,927	32	2,257	47	3,776
DEC	215	111	39	65	176	12,313	88	5,531	39	2,768	49	4,014
1987												
JAN	208	120	41	47	175	12,143	95	5,864	38	2,718	42	3,561
FEB	243	153	42	48	n.a.	n.a.	n.a.	n.a.	44	3,255	33	2,812
MAR	307	190	49	68	n.a.	n.a.	n.a.	n.a.	60	4,420	39	3,339
1986 TOTAL	3,283	1,908	452	923	1,770	122,474	839	51,616	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
4 MONTHS												
1987	n.a.	628	n.a.	242	n.a.	n.a.	n.a.	n.a.	182	13,414	158	13,511
1986	1,099	747	113	239	455	30,948	222	13,797	78	5,467	155	11,684
1985	636	246	65	325	368	22,687	93	5,215	51	2,360	224	15,112
1984	634	173	76	385	445	28,300	86	4,535	82	5,308	277	18,457

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
NOV	1,811	2,549	93,525	5,636	8,926	9,356	9,862	10,540	13,319	9,612
DEC	1,272	2,336	97,174	5,494	7,993	8,742	11,306	11,579	10,377	12,123
1987										
JAN	948	1,346	101,687	6,363	n.a.	n.a.	n.a.	n.a.	13,932	10,624
FEB	912	979	104,670	4,691	n.a.	n.a.	n.a.	n.a.	11,668	9,692
MAR	2,805	1,435	107,673	4,627	n.a.	n.a.	n.a.	n.a.	10,873	10,736
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
4 MONTHS										
1987	7,873	5,877	—	22,678	n.a.	n.a.	n.a.	n.a.	51,523	42,986
1986	9,584	5,388	—	12,037	106,563	136,179	103,474	102,433	44,264	22,262
1985	6,751	7,273	—	5,676	44,025	56,689	44,012	41,454	14,741	10,683
1984	6,889	6,597	—	4,284	30,743	34,737	21,885	20,489	12,266	10,216

*FHLMC Year to date totals are periods Jan.-Dec. 1984-1986.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
DEC	9.21%	9.33%	9.36%	9.69%	9.65%	7.94%	8.973%	11.09%
1987								
JAN	8.79	9.09	9.10	9.51	9.53	8.31	8.815	10.81
FEB	8.81	9.04	9.04	9.23	9.21	8.48	8.668	10.25
MAR	8.94	9.19	9.20	9.14	9.09	8.06	8.633	10.24
APR	10.02	10.11	10.14	9.21	9.09	8.35	9.655	12.08

CURRENT SECONDARY MARKET YIELDS

SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
DEC	8.40%	8.48%	8.50%	9.08%	7.11%	5.53%	6.10%
1987							
JAN	8.22	8.31	8.26	8.92	7.08	5.44	5.84
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05
MAR	8.12	8.25	8.22	8.84	7.25	5.59	6.16
APR	9.06	9.13	9.08	9.51	8.02	5.90	6.45

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
DEC	29	129	137	139
1987				
JAN	−13	114	123	118
FEB	−1	81	96	92
MAR	10	87	100	97
APR	51	104	111	106

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING

AUGUST 1987

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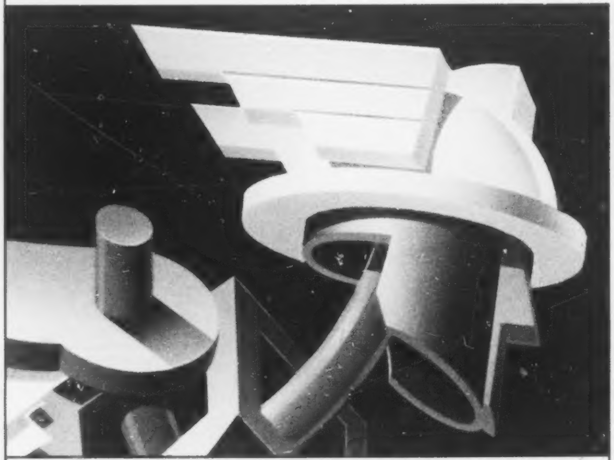
MORTGAGE BANKING

VOLUME 47 NO. 11
AUGUST 1987



ARTICLES

PAGE 8
COST OF SERVICING: THE ERODING RETURNS
Dr. Victor Cholewicki
This exclusive article details the cost of servicing loans in 1986. Net servicing expenses soared to $95 per loan which was a 34 percent increase above last year. Read all about why costs have skyrocketed and what reasons caused it.

PAGE 24
OUTCLASS THE COMPETITION WITH SERVICE DISTINCTION
Clifford D. Moore, III
Service quality is hard to define and difficult to measure so few mortgage banking firms have attempted to monitor it. But because consumers complain to branch offices instead of to middle or senior management the costs of low-income quality, including customer turnover, may not be evident to managment. Dissatisfied buyers will change suppliers rather than complain.

PAGE 41
CERTIFIED MORTGAGE BANKERS: THE WOMEN AT THE TOP
Several women CMBs share their insights on how the designation has furthered their careers in real estate finance and why more people should aspire to attain it.

PAGE 50
LASER: FLEET OF FOOT LOAN MANAGEMENT
Richard M. Leegant
LASER permits Fannie Mae to fund most loans within three to four days, rather than nine days. It captures loan information from commitment through delivery, payment applications and final liquidation modifying information along the way. Learn more about the future of LASER in this article.

PAGE 61
SOUND SERVICING PROGRAMS: THE MODERN CURE FOR DEFAULTS AND FORECLOSURES
L. Rick Butler
Audits of servicing departments across the nation reveal that most lenders have servicing programs that are obsolete or non-existent. This article explains how foreclosure is being used as an early collection tool rather than as the last alternative.

PAGE 73
NON-EARNING ASSETS: NEVER RISK THE UNKNOWN
Eric L. Stewart and E.S. Olrich
One of the greatest risks of managing non-earning assets is not having all the facts readily available. Then management gets caught with costly surprises because there is a lack of information to use to evaluate potential problem areas.

PAGE 83
PROACTIVE SERVICING MANAGEMENT PRODUCES THE PROFITS
Mary Bruce Batte
The ultimate of proactive servicing management is not only creating a buy/sell plan for servicing rights and making functions profitable but also evaluating and selecting loan production strategies and pricing.

PAGE 90
TEAMWORK: CHARTING A COURSE FOR SUCCESS
Gregory T. Barmore
Winning at mortgage lending is not unlike winning in yacht racing. The winner is the one with perfect execution and that requires top performance from each crew member, aimed at ensuring the team's success.

PAGE 97
MORTGAGE SERVICING SYSTEM: A CASE STUDY BY A MAJOR MORTGAGE LENDER
Douglas R. LaBoda
Learn how Travelers selected and implemented a mortgage servicing system in this article. Companies who are working to replace an old system should consider several fundamental points.

PAGE 103
BUSINESS BASICS COLLECTION TECHNIQUES: SURVIVING THE 1980s
Charles D. Bertrand
Morgage lenders may not be able to change economic conditions, but they can change the public's perception about the consequences of default. Lenders need to adopt a policy that calls for reasonable efforts to collect every deficiency.

DEPARTMENTS

ABOUT THE ISSUE 3
BUSINESS BASICS 103
PEOPLE 108
BOOKS 116
SECONDARY MORTGAGE MARKETS 119
MORTGAGE MARKET TRENDS 121
AD INDEX 130

Dr. Victor Cholewicki

COST OF SERVICING

The Eroding Returns

A surge in mortgage loan prepayments, together with deepening delinquency and foreclosure problems, worsened by the Veterans Administration's (VA) increasing use of its no-bid option on foreclosed properties, wracked the servicing operation in 1986. Net servicing expenses soared to $95 per loan, a 34 percent increase above the prior year's figure. At the same time, firms saw a large portion of their investment in servicing rights wash away as the underlying loans were prepaid, requiring the accelerated expensing of the remaining unamortized portion of the purchase price. These massive cost increases, in the face of a moderate rise in income, resulted in a 40 percent plunge in net servicing income per loan and a drop in before tax profit margin for the servicing operation to an unprecedented 26 percent.

The stark rise in unit servicing costs was accompanied by a disappointingly small gain in servicing volume. At first glance it might have been anticipated that the 1986 flood of origination volume would result in significantly stronger portfolio growth than that of the prior year. However, even though mortgage bankers' 1986 single-family origination volume increased by 108 percent, as reported by the Department of Housing and Urban Development (and confirmed in the Mortgage Bankers Association survey), firms reporting in 1986 experienced only a 14 percent rate of growth of dollar volume serviced and a mere 3 percent increase in number of loans serviced (See Table 1). A full 41 percent of the 1986 sample reported a decline in number of loans serviced. One geographic region, the West, experienced an 11 percent drop in this figure.

Even taking into account the high refinance volume, which is estimated to have amounted to 40 percent of the dollar volume of all single-family loans closed in 1986, the portfolio growth figures are surprisingly small. In comparison, the 1985 survey showed an increase of 15 percent in dollar volume serviced while the number of loans serviced rose 7 percent. These magnitudes were achieved in a year in which mortgage bankers' single-family origination volume was barely more than half their 1986 level, but in which refinancings accounted for an estimated 15 percent of total single-family origination volume.

The somewhat slower than expected portfolio growth in 1986 was largely the result of an increase in the net sale of servicing rights by survey respondents in bulk form, in contrast to the large purchases of 1985. Firms sold servicing for a variety of reasons—to improve cash flow, pay off long-term debt, restructure their portfolios, etc. However, for many firms the motivation was to fund foreclosure losses and to strengthen their financial positions, as they faced an 81 percent increase in the dollar volume of real estate owned in 1986 compared with their 1985 level.

Servicing income

Servicing income rose to $180.53 per loan, a 6 percent increase compared with the 1985 figure of $170.80 (See Tables 2 and 3 with footnotes). This item has grown at a somewhat slower pace than the average loan size serviced during the past three years. Although servicing fees have kept pace with increases in the average size loan serviced, as servicing fee as a percent of dollar volume serviced remained virtually unchanged, large increases in net losses on foreclosures have resulted in a steady decline in servicing income as percent of dollar volume serviced. This figure fell to 44 basis points in 1986 compared with

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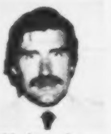
the 47 basis points recorded in 1984.

Net losses on foreclosures have been steadily worsening during the past six years and show no sign of improvement in the near future (See Table 4). The 1986 figure of $10.49 per loan represents a 55 percent increase above the $6.77 level recorded the prior year. As recently as 1983 this item was $1.75. Much of the increase stems from expenses incurred on foreclosures on VA loans, with a major factor being the increased use by VA of its no-bid option. The no-bid option is currently being invoked in about 15 percent of all foreclosures on VA loans. The loss on a single no-bid VA foreclosure can run into tens of thousands of dollars. For firms whose portfolios consist of 30 percent or more of VA loans (dollar volume), the losses on foreclosure per loan serviced item was, on average, well in excess of $20.

The VA foreclosure problem is especially important to mortgage bankers, who service the majority of outstanding VA loans. The fact that 21 percent of the average firm's servicing portfolio consists of VA loans, and that there is no clear indication yet that the percentage of loans in long-term delinquency and foreclosure is subsiding, indicate that this negative income item cannot be expected to improve in the near term.

Servicing expenses

Net servicing expenses soared to $95.08 per loan in 1986, a full 34 percent higher than the $71.01 figure of the prior year (See Table 5). As a percent of the dollar volume of loans serviced, net servicing expenses reached 23 basis points, well above the 17 to 19 basis point range of the previous seven years. In addition, the amortization of the cost of purchased servicing, the balance of the gross expense item, nearly doubled on a per loan basis, reaching $39.46 per loan compared with the $23.88 figure recorded in 1985. Thus, gross servicing expenses increased to $134.54 per loan in 1986, a full 42 percent rise above the prior year's $94.89 figure.



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Last year's burst of origination volume, with its large refinance component, brought a major inflow of new loans to firms' servicing portfolios, which was almost matched by the outflow from the portfolios. In effect, market forces were churning the portfolio. As a result, servicing staffs were swamped with accelerated demands for new loan set-up as well as the processing of payoff requests. In addition, the worsening delinquency and foreclosure problems caused a need for more staff in the collection and foreclosure, and for some, the real estate owned (REO) departments. Firms responded with an 8 percent increase in their number of loan administration personnel.

Despite the burgeoning demands on the staff, loan administration personnel expenses per loan increased only 12 percent last year, reaching $37.62 compared with the $33.58 figure of the prior year (See Table 6). This was only slightly higher than the percent increase in average loan size serviced, leaving personnel expenses as percent of dollar volume serviced virtually unchanged at 9 basis points. The direct loan administration compensation component increased to $31.25, a 15 percent increase above the prior year's figure. (There was a modest decline in the remaining personnel expense components). The increase in direct compensation per loan serviced was the result of an 11 percent rise in average loan administration personnel salaries to $16,885 and a 5 percent fall in the number of loans serviced per servicing employee to 549. These figures were $15,187 and 579, respectively, in 1985. The rise in personnel salaries, following a slight decline the previous year, was only partly the result of cost of living increases. Perhaps a more important factor was the fact that many of the new hires were in the higher salaried collections, foreclosure and REO departments. In some cases REO staff was remunerated on a commission basis, which added still more to personnel compensation expenditures.

The unusually high rate of turnover of the servicing portfolio had a major effect on the more efficient servicers, driving down considerably their number of loans serviced per servicing employee. Only 11 firms, or 9 percent of the sample, achieved the level of 700 or more loans serviced per employee in 1986. In 1985, 20 percent of the sample achieved this level of productivity while in 1984 the figure was 26 percent. Fifteen of the 20 firms whose number of loans serviced per employee exceeded 700 in the 1985 survey reported in the 1986 survey as well. In 1985 this group averaged 807 loans serviced per employee; this figure fell to 677 in 1986. Only six of the fifteen who attained the 700 level in 1985 reached that level in 1986. However, these firms were, for the most part, up among the leaders both years.

Occupancy

Occupancy expenses reached $4.58 per loan and $2,475 per servicing employee in 1986, increases of 25 percent and 21 percent, respectively, over the previous year's levels. (See Table 7). A major part of the increases in these items can be attributed to a more careful allocation by the 1986 survey respondents. The roughly 8 percent growth in loan administration staff, together with a slight decrease in the number of loans serviced per employee, accounted for some of the additional expenses, especially on a per loan basis. Also, some firms incurred substantial costs in this area through the restructuring of servicing operations and the consolidation of existing operations. For others the temporary scaling down of the operation in the wake of a large servicing sale or transfer also added to costs on a per unit and per employee basis.

There appears to be a size threshold for achieving cost efficiencies in the occupancy component of the servicing operation. Smaller firms, those servicing less than $300 million have, on average, significantly higher occupancy expenses on both a per employee and a per loan serviced basis. These firms average $4,188 in occupancy expenses per servicing employee and $13.86 per loan. This compares with the $2,000 to $2,500 range per employee and $4 to $7 range per loan for larger firms. However, occupancy expenses do not appear to have a strictly inverse relationship to firm size. The lowest occupancy expense per employee figure was the $2,016 per employee figure recorded by the $1 to $2 billion size category, which was significantly below that of neighboring size categories.

The somewhat slower than expected portfolio growth in 1986 was largely the result of an increase in the net sale of servicing rights by survey respondents in bulk form, in contrast to the large purchases of 1985.

Electronic data processing

Electronic data processing expenses (EDP) per loan (Table 7) rose 35 percent to $9.05 per loan in 1986, while EDP expenses per servicing personnel increased 30 percent to $4,889. This was largely the result of the surge in mortgage loan prepayments and does not reflect a major increase in investment in automated systems. Heavy prepayment activity requires a well above average number of inquiries as to loan status and current principal balance. An unusually high number of inquiries is especially costly to firms using service bureaus, where servicers are billed on a per inquiry basis after their initial allotment has been exhausted. Unusually heavy usage is also a significant factor for those with in-house data processing systems. Also, services on which annual fees are paid add to unit costs when loans pay off in mid-year.

In examining the other direct expenses category it is useful to consider the enumerated items such as telephone and postage, and other supplies separately from the all other operating expense item. In the aggregate, the enumerated other direct expenses items reached $12.77 per loan, an 11 percent increase above the comparable 1985 figure. This was the result of the increased demands and workload caused by the heavy prepayment environment of 1986. However, the increased workload does not explain the 78 percent increase in all other operating expenses. This item reached $18.88 per loan in 1986 compared with the $10.62 figure of the prior year. The vast majority of this increase appears to be payoff expenses—the cost of paying off the balance of the month's interest to the investor on loans that prepay in the middle of the month. (Not all loans have this requirement.) These expenses were a major cost element in the servicing operation in 1986, in contrast to previous years when they were a relatively insignificant item. However, even though exceptionally large payoff expenses were incurred by servicing operations, there was at least a partial offset to the firm—the use by the treasury of the paid off principal balance for the remainder of the month. Relatively few firms credited their servicing operations with the value generated by having the free use of the paid off principal balance of prepaying loans. As a result, most firms with heavy pay off expenses will probably show higher profitability in their warehouse operation from the use of the prepaid principal balances in funding loan production and supporting credit lines.

Another, less important, part of the all other operating expenses item was the amortization of excess servicing fees. This was a significant expense in 1986 as many firms chose to take excess servicing fees in a declining interest rate environment and enter the capitalized value on their balance sheets. For the most part, this item was netted out of servicing fee income. However, a small portion was entered as operating expenses.

Provisions for loan losses rose a startling 144 percent for the average firm in 1986, reaching $12.19 per loan. Continuing increases in the longer period delinquency rates was the major cause of the increase. Many firms increased their funding of reserves in anticipation of a continuation or worsening of delinquency problems in the near term.

Purchased servicing

The purchased servicing component of gross servicing expenses—that is, the amortization of the cost of purchased servicing (ACPC)—rose even faster than the net expense portion, increasing 65 percent to $39.46 per loan in 1986 compared with the $23.88 level of the prior year.

Sales volume in the secondary servicing market appears to have increased in 1986 even though survey respondents on balance gained less in bulk servicing rights than in the previous year. More and more firms are beginning to view both the purchase and sale of servicing rights as a standard part of their operation, to be used for a variety of purposes beyond the traditional function of generating cash flow. Transactions aimed toward portfolio restructuring, in particular, have grown markedly as firms strive for low delinquency, higher average principal balance portfolios. But because these sales typically involve mortgage banking firms trading among each other, each firm's amortization item increases while the total servicing volume for the group as a whole remains little changed. In addition, the greater willingness of the market to deal in smaller blocs of bulk servicing (as small as $20 to $30 million in some cases) has opened the door to many medium to small size firms. All of this has made for a more competitive market, causing an increase in the price of servicing, especially for the highly regarded current production.

Whereas the brisk pace of servicing

purchases in 1986 added to the ACPC, a large part of the jump in this expense item can be attributed to high prepayment rates. When loans whose servicing rights were purchased prepay at a faster than anticipated rate, the remaining unamortized portion of the purchase price must be expensed at an accelerated rate. Thus a major part of the increase in this item was the moving forward of investment expenses for assets that had depreciated faster than had been anticipated.

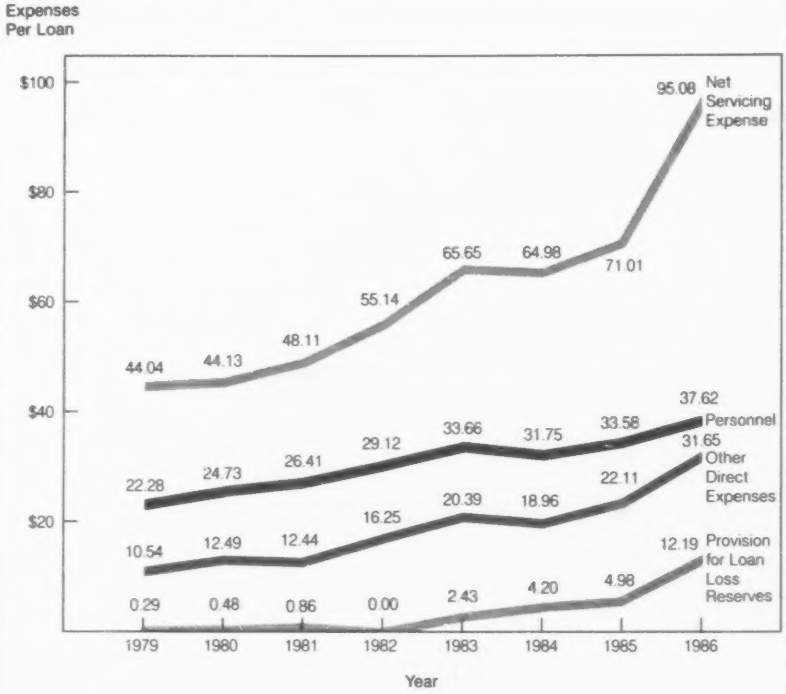
Confining our attention to the firms that reported in both 1986 and 1985, the repeat reporters, allows for a closer look at the relationship between the amortization of the cost of purchased servicing and the growth of the servicing portfolio. (ACPC figures are available for both years). These firms comprise 59 percent of the 1986 sample and have per loan figures which are remarkably close to the figures for the entire survey. Thus, they are highly representative of the full list of 1986 reporters.

Repeat reporters showed an increase in the amortization of the cost of purchased servicing of 106 percent in 1986 compared with 1985. During the same period their aggregate dollar volume of servicing rose 14 percent while their number of loans serviced rose only 2 percent. After generating 777,000 in loan originations (the total of in-house plus purchased production) in 1986, these firms ended the year

The stark rise in unit servicing costs was accompanied by a disappointingly small gain in servicing volume.

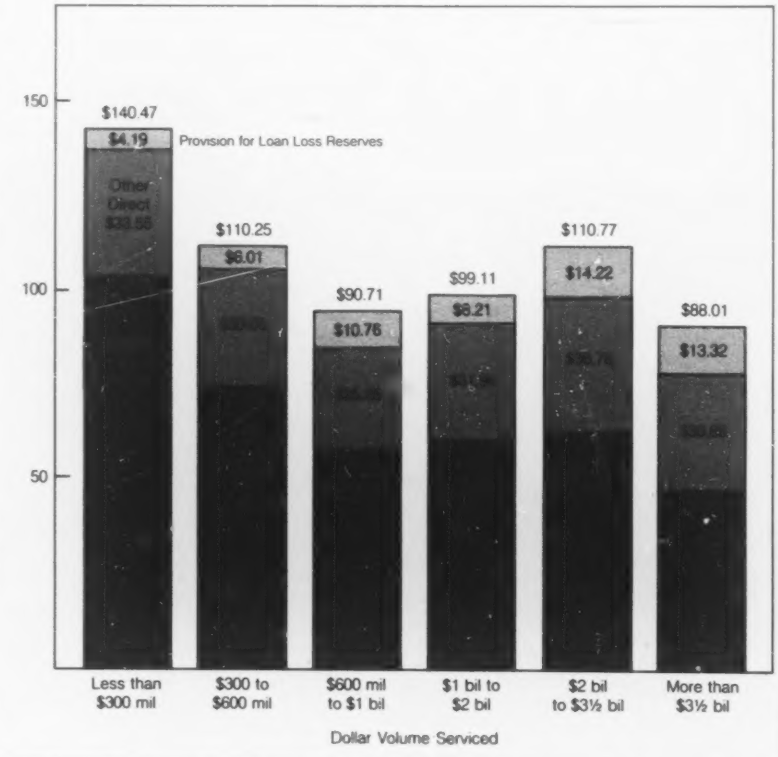
GRAPH 1

Selected Servicing Cost Components, 1979-1986



GRAPH 2

Selected Servicing Cost Components, 1986, by Dollar Volume Serviced



with a net increase in number of loans serviced of only 89,000. Several firms in this group reported substantial increases in the amortization figure while sustaining a decrease in the number of loans serviced. These figures support the view that the premature prepayment of purchased servicing was a large factor underlying the unprecedented jump in the amortization of the cost of purchased servicing item in 1986.

Cost factors

High prepayment rates and deepening delinquency and foreclosure problems were the dominant factors affecting servicing costs in 1986. These factors simply overwhelmed many of the relationships between firm characteristics and unit costs that held in prior years. However, some of these relationships were still found to hold in 1986.

The largest firms, those servicing more than $3½ billion, were found to have the lowest unit costs of the dollar volume size categories—but not by much (See Table 8). These firms averaged $88.01 in expenses per loan serviced, which was $7 below the survey average. However, firms in the $600 million to $1 billion range recorded unit costs of $90.71 while firms in the $2 to $3½ billion range incurred costs of $110.77 per loan. In addition, when the very largest servicers are broken out (those servicing more than $5 billion) their unit costs were a shade higher than those in the $3½ to $5 billion category. Thus, the efficiency to size relationship appears to have been somewhat skewed by the unusual environment of 1986.

The relationship between unit cost and number of loans serviced was much less erratic in 1986 than its dollar volume counterpart. Again, the largest servicers (those servicing more than 80,000 loans) were the most efficient, attaining unit costs of $88.73. However, each of the next three size categories, covering firms servicing from 8,000 to 80,000 loans had almost identical unit costs of approximately $102.

The size breakouts in the 1986 survey show that the area in which the very large firms (more than $3½ billion serviced) enjoyed their greatest advantage was in personnel expenses. For example, the firms in the largest

TABLE 1

Portfolio Dynamics

	1986	1985	1984
Rate of Growth of Dollar Volume Serviced	14.4%	15.1%	13.5%
Rate of Growth of Number of Loans Serviced	3.1%	7.0%	6.9%
Total Servicing Acquisition* Ratio ($)	0.39	0.71	0.70
Average Loan Size Serviced	$41,263	$37,573	$34,946
Percent Increase in Average Size Loan Serviced	9.8%	10.7%	6.4%

*The *total* servicing acquisition ratio is the increase in servicing volume divided by the total of in-house and purchased loan production. It differs from the previously quoted servicing acquisition ratio in that it includes purchased production in the denominator.

TABLE 2

Servicing Income and Expenses* Per Loan, Average Firm, 1984-1986

	1986	1985**	1984
INCOME			
Servicing Fees	$161.12	$148.38	$138.13
Servicing—1st Mortgages	160.65	148.07	137.81
Servicing—2nd Mortgages	0.47	0.31	0.32
Gain Foreclosure	(10.49)	(6.77)	(4.99)
Other Loan Administration Income	29.90	29.19	31.32
GROSS SERVICING INCOME	$180.53	$170.80	$164.35
EXPENSES			
Servicing Personnel	$37.62	$33.58	$31.75
Loan Administration	31.25	27.06	26.47
Management	0.21	0.23	0.22
Directors	0.00	0.00	00.3
Others	0.86	0.99	0.21
Fringe Benefits	5.08	5.30	4.82
Education and Training	0.23	N.C.	N.C.
Occupancy	4.58	3.66	3.67
EDP	9.05	6.68	6.40
Other Direct	31.65	22.11	18.96
Other Equipment	1.67	1.36	1.30
Telephone and Postage	6.69	6.18	5.37
Other Supplies	2.83	2.39	2.10
Travel	0.50	0.61	0.69
Automobile	0.11	0.10	0.21
Advertising	0.07	0.06	0.09
Legal and Auditing	0.91	0.79	0.90
All Other Operating Expenses	18.88	10.62	8.30
Provision for Loan Loss Reserves	12.19	4.98	4.20
NET SERVICING EXPENSE	$95.08	$71.01	$64.98
AMORTIZATION OF THE COST OF PURCHASED SERVICING	$39.46	$23.88	$20.15
NET SERVICING INCOME	$45.99	$75.91	$79.22
Number of Firms	124	101	111

*Only income and expenses that pertain to the day-to-day operation of the servicing operation are included in these figures. Excluded from income are net gains on the sale of servicing rights. Excluded from expenses are items such as amortization of goodwill and of organizational structure that reflect "push down" accounting treatment.
**Income and expense figures for 1985 have been adjusted to incorporate corrections in the data supplied for that year.

dollar volume category incurred personnel expenses per loan of $31.52. No other size range recorded less than $41 for this item. Also, the largest servicers in terms of dollar volume attained an average of 608 loans serviced per employee, compared with the next highest figure of 515 loans serviced per employee in the $600 million to $1 billion range. It appears that the organizational structure of firms in the largest dollar volume servicing category enabled them to better cope with the suddenly increased workload than those in the smaller size categories. Whether this major advantage will carry over into periods of less frantic work pace is an interesting question.

Portfolio turnover

The rapid portfolio turnover in the servicing operation in 1986 made the breakouts in terms of portfolio dynamics less useful than in prior years. While it remained true that a moderate rate of portfolio growth tended to be associated with relatively low unit costs, these costs reflected a higher than normal rate of turnover of loans and were, therefore, significantly higher than their counterparts of previous years. For example, firms with a rate of growth of dollar volume in the 0 to 10 percent range recorded unit costs of $81.45. However, the 0 to 10 percent growth represented a much higher rate of portfolio turnover than this category experienced in prior survey years.

Net losses on foreclosures have been steadily worsening during the past six years and show no sign of improvement in the near future.

TABLE 3

Servicing Income

	1986	1985	1984
INCOME, per loan			
Servicing Fees	$161.12	$148.38	$138.13
Net Gain on Foreclosures	(10.49)	(6.77)	(4.99)
All Other Income	29.90	29.19	31.21
Total Gross Servicing Income	$180.53	$170.80	$164.35
Total Gross Servicing Expense	$134.54	$ 94.89	$ 85.13
Net Servicing Income	$ 45.99	$ 75.91	$ 79.22
Servicing Profit Margin (Before Tax)	25.5%	44.4%	48.2%
Servicing Income as Percent of Dollar Volume Serviced	.438	.455	.470
Net Servicing Income as Percent of Dollar Volume Serviced	.112	.202	.227
Servicing Fees as Percent of Dollar Volume Serviced	.390	.395	.394

TABLE 4

Net Loss On Foreclosures and Provision For Loan Loss Reserves, Per Loan

	1986	1985	1984	1983
Net Loss on Foreclosures	$10.49	$6.77	$4.99	$1.75
Provision for Loan Loss Reserves	$12.19	$4.98	$4.20	$2.43
Rate of Increase of Real Estate Owned above Prior Year	81%	39%	70%	23%

TABLE 5

Servicing Expenses

	1986	1985	1984
EXPENSES, per loan:			
Personnel	$ 37.62	$33.58	$31.75
Occupancy	4.58	3.66	3.67
EDP	9.05	6.68	6.40
Other Direct	31.65	22.11	18.96
Provision for Loan Loss Reserves	12.19	4.98	4.20
TOTAL NET SERVICING EXPENSE	$ 95.08	$71.01	$64.98
Amortization of the Cost of Purchased Servicing	$ 39.46	$23.88	$20.15
Total Gross Servicing Expense	$134.54	$94.89	$85.13
Servicing Expense Ratio*	.230	.189	.186

*Net servicing expense as percent of dollar volume serviced

The total servicing acquisition ratio, which was designed to take into account the rate of portfolio turnover provides some help in the analysis of the 1986 data. But first it should be noted that this ratio differs from the servicing acquisition ratio introduced in the 1984 study. The *total* servicing acquisition ratio is calculated as the increase in dollar volume serviced divided by the total of in-house plus purchased mortgage loan production. (The servicing acquisition ratio of the 1984 study had only in-house production in the denominator.) This ratio represents the net gain in dollar servicing volume relative to the dollar volume of servicing rights the firm generated during the year. The ratio declines as the result of either large sales of servicing or high prepayment rates or both. A total servicing acquisition ratio in the .9 to 1 range typically indicates an operation in which little servicing is lost and almost all of the loans originated are added to the servicing portfolio.

Firms with total servicing acquisition ratios in the .9 to 1.1 range in 1986 were found to have unit costs of $80.03 and 641 loans serviced per employee. Both figures are significantly better than the survey average. However, the vast majority of firms in the 1986 survey (93 out of 124) had total servicing acquisition ratios below .65. This is to be expected in a high prepayment environment. Unfortunately, costs are not systematically related to the total servicing acquisition ratio when that ratio is in its lower ranges.

Average loan size

Interestingly enough, the categorization that generates the clearest explanation of unit costs is that produced by grouping firms by average loan size serviced. Although this relationship has held in previous years, it was especially striking in the 1986 survey. Firms servicing loans with average principal balance of under $30,000 incurred costs of only $66.82 per loan in 1986. Firms in the $30,000 to $40,000 range experienced unit costs of roughly $82. An orderly upward progression was found to exist up through the more than $65,000 category, where the average firm recorded unit costs of $186.62 (of which $46.03 was in the provisions for loan loss item). The same relationship between loan size and unit costs was found to hold when firms were grouped by unit servicing cost. (See Table 9.)

It is not surprising that the average loan size serviced would correlate especially well with unit costs in a high prepayment rate and high delinquency rate environment. The lower principal balance loans are typically highly seasoned, putting them well beyond the five to seven year loan life range in which delinquency and foreclosure problems typically arise. Also, the lower contract interest rates on these loans make them unlikely refinance candidates, thus holding down their prepayment rate. As a consequence, firms with extremely low average principal balance loans were able to avoid the major cost-inflating factors that characterized the vast majority of servicers.

Further analysis using a measure designed to quantify the degree of seasoning of the servicing portfolio, the loan size ratio, confirms the importance of the degree of seasoning as a major determinant of unit cost in 1986. The loan size ratio, which is defined as the average size loan serviced divided by average size of current production loans, allows for the detection of highly seasoned portfolios of loans that were originated in high cost areas. Firms with a loan size ratio of less than .45 (which compares with the survey average of .56) recorded unit costs of $68.09. (Firms with average loan size serviced under $30,000 had a loan size ratio of .42 in the aggregate.)

Outlook

Despite the run-up in costs last year, the prospects for the servicing operation are promising. The likelihood of another avalanche of refinancings in the near term is small because so many outstanding loans have already been refinanced, and interest rates seem unlikely to drop significantly further. Thus, the run-up in expenses associated with high prepayment rates should be reversed. The increasingly costly delinquency and foreclosure problems are not expected to fade away soon. However, the servicing that was put on the books from 1986 production is of unusually high quality. The underlying loans carry contract interest rates of 9 to 10½ percent and should stay on the books for a relatively long period of time as they are not good refinance candidates in any of the likely interest rate scenarios. They are more strictly underwritten and typically have lower loan-to-value ratios than those originated in the earlier years of the decade. The refinance loans in particular have perhaps the highest value. The fact the borrower was able to consistently meet his mortgage payment obligations at his old rate and will now have lower monthly payments suggests that these loans will face minimal delinquency and foreclosure problems in

TABLE 6

Personnel

	1986	1985	1984
Number of Loans Serviced per Servicing Employee	549	579	591
Average Salary, Loan Administration Personnel	$16,885	$15,187	$15,256
Total Personnel Expenses per Loan	$37.62	$33.58	$31.75
Personnel Expense as Percent of Dollar Volume Serviced	.091	.090	.103
Personnel Expense as Percent of Net Servicing Expense Less Provision for Loan Loss Reserves	45%	51%	52%

TABLE 7

Other Expense Components

	1986	1985	1984
Occupancy Expenses per loan	$4.58	$3.66	$3.67
Occupancy Expenses per Loan Administration Employee	$2,475	$2,053	$2,118
Occupancy Expenses as percent of Dollar Volume Serviced	.011	.010	.011
EDP Expense per loan	$9.05	$6.68	$6.40
EDP Expense per Loan Administration Employee	$4,889	$3,747	$3,687
EDP Expense as percent of Dollar Volume Serviced	.022	.018	.018
Other Direct Expenses per loan	$31.65	$22.11	$18.96
Other Operating Expenses as Percent of Dollar Volume Serviced	.077	.059	.054

TABLE 8

INCOME STATEMENT: Servicing, by Dollar Volume Serviced, 1986

INCOME, per loan	Less Than $300 mil	$300 to $600 mil	$600 to $1 bil	$1 bil to $2 bil	$2 bil to $3½ bil	More than $3½ bil	Average Firm
Servicing Fees	$186.28	$176.38	$177.15	$160.73	$172.86	$154.24	$161.12
Net Gain Foreclosure	(11.38)	(27.63)	(13.88)	(8.12)	(16.94)	(7.73)	(10.49)
All Other Income	28.80	29.64	23.48	34.26	23.90	31.42	29.90
TOTAL SERVICING INCOME	$203.69	$178.39	$186.74	$186.87	$179.81	$177.92	$180.53
EXPENSES, per loan							
Personnel	$ 73.37	$ 52.56	$ 41.97	$ 44.25	$ 44.90	$ 31.52	$ 37.62
Occupancy	13.86	6.80	4.95	4.18	5.64	3.99	4.58
EDP	15.51	14.83	7.78	10.50	9.24	8.30	9.05
Other Direct	33.55	30.06	25.25	31.96	36.78	30.88	31.65
Provision for Loan Loss Reserves	4.19	6.01	10.76	8.21	14.22	13.32	12.19
TOTAL NET SERVICING EXPENSE	$140.47	$110.25	$ 90.71	$ 99.11	$110.77	$ 88.01	$ 95.08
ACPC (Amortization of cost of purchased servicing)	$ 7.44	$ 25.48	$ 23.59	$ 24.88	$ 39.88	$ 46.63	$ 39.46
NET SERVICING INCOME	$ 55.78	$ 42.65	$ 72.44	$ 62.88	$ 29.16	$ 43.28	$ 45.99
ANCILLARY DATA							
Servicing Fee (%)	0.413	0.430	0.431	0.375	0.400	0.383	0.390
Servicing Expense Ratio	0.311	0.269	0.221	0.232	0.257	0.219	0.230
Net Servicing Income (%)	0.124	0.104	0.176	0.147	0.068	0.108	0.112
Profit Margin (Before Tax)	27.4%	23.9%	38.8%	33.6%	16.2%	24.3%	25.5%
# Loans Serviced Per Employee	313	404	515	489	511	608	549
Average Salary, Loan Administration	$17,865	$16,460	$16,341	$18,235	$18,617	$15,930	$16,885
Average Loan Size Serviced	$45,145	$40,997	$41,084	$42,805	$43,178	$40,238	$41,263
Percent Growth of Dollar Volume Serviced	14.4%	14.7%	11.5%	20.9%	8.7%	15.0%	14.4%
Total Servicing Acquisition Ratio	0.11	0.29	0.33	0.41	0.28	0.45	0.39
Number of Firms	25	17	21	27	16	18	124

TABLE 9

Servicing Expenses, Per Loan: Grouped By Unit Cost

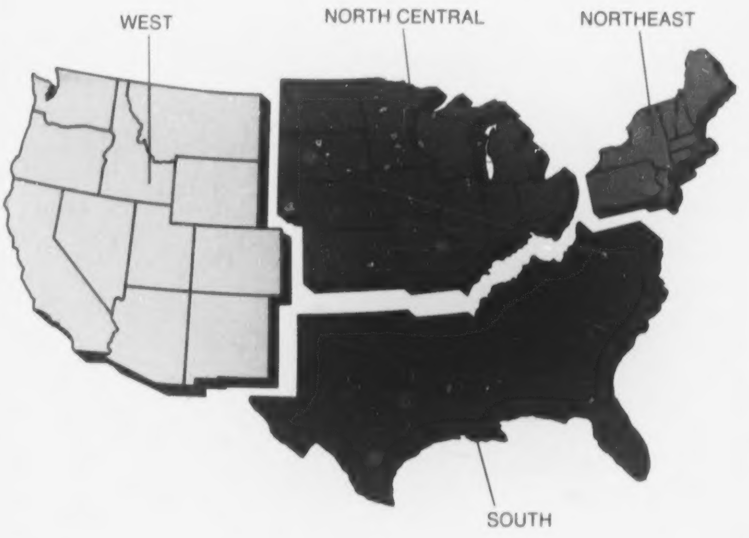
EXPENSES, per loan	Less Than $70	$70 to $80	$80 to $100	$100 to $125	$125 to $175	More than $175	Average Firm
Personnel	$28.02	$34.08	$31.69	$ 43.38	$ 56.93	$ 71.33	$37.62
Occupancy	2.51	3.54	3.46	7.02	6.61	9.46	4.58
EDP	4.81	7.09	6.48	14.95	11.49	18.91	9.05
Other Direct	21.27	26.67	24.56	40.83	49.40	65.22	31.65
Provision for Loan Loss Reserves	1.09	1.75	23.49	5.05	24.68	74.62	12.19
TOTAL NET SERVICING EXPENSE	$57.70	$73.14	$89.68	$111.22	$149.12	$239.54	$95.08
ACPC (Amortization of the cost of purchased servicing)	$36.26	$30.42	$45.10	$46.25	$34.13	$25.01	$39.46
ANCILLARY DATA							
Servicing Fee (%)	0.342	0.423	0.395	0.389	0.449	0.416	0.390
Profit Margin (Before Tax)	36.3%	39.1%	23.3%	18.5%	22.0%	0.7%	25.5%
Servicing Expense Ratio	0.158	0.199	0.223	0.251	0.312	0.405	0.230
# Loans Serviced Per Employee	627	581	621	515	400	378	549
Average Loan Size Serviced	$36,562	$36,758	$40,278	$44,325	$47,730	$59,092	$41,263
Percent Growth of Dollar Volume Serviced	10.9%	9.4%	18.1%	18.4%	11.1%	24.0%	14.4%
Total Servicing Acquisition Ratio	0.39	0.39	0.40	0.44	0.26	0.33	0.39
Number of Firms	24	19	22	21	20	18	124

TABLE 10

Income Statement, Servicing, by Geographical Region (1986)

INCOME, per loan	Northeast	South	Midwest	West	Average Firm
Servicing Fees	$181.25	$162.88	$130.76	$183.02	$161.12
Net Gain Foreclosure	(0.98)	(11.42)	(7.41)	(24.96)	(10.49)
All Other Included	26.36	28.96	32.53	33.73	29.90
TOTAL SERVICING INCOME	$206.63	$180.42	$155.88	$191.79	$180.53
EXPENSES, per loan					
Personnel	$ 36.92	$ 35.73	$ 34.00	$ 48.48	$ 37.62
Occupancy	5.60	4.12	3.67	5.86	4.58
EDP	12.86	8.25	6.81	8.40	9.05
Other Direct	32.34	29.44	30.28	39.11	31.65
Provision for Loan Loss Reserves	12.22	12.86	11.08	11.56	12.19
TOTAL NET SERVICING EXPENSE	$ 99.93	$ 90.40	$ 85.84	$113.41	$ 95.08
ACPC	$ 44.03	$ 35.26	$ 37.45	$ 46.16	$ 39.46
NET SERVICING INCOME	$ 62.67	$ 54.76	$ 32.59	$ 32.22	$ 45.98
Profit Margin (Before Tax)	30.3%	30.4%	20.9%	16.8%	25.5%
Servicing Fee (%)	.422	.406	.349	.376	.390
Loans Serviced per Employee	546	543	608	478	549
Average Salary, Loan Administration	$16,267	$16,176	$15,315	$19,812	$16,885
Growth in Dollar Serviced	12.3%	12.7%	29.2%	3.6%	14.4%
Growth in Number Serviced	3.8%	2.7%	11.8%	−11.4%	3.1%
Total Servicing Acquisition Ratio	.315	.379	.668	.099	0.39
Servicing Expense Ratio	233	.225	.229	.233	.231
Average Loan Size	$42,961	$40,123	$37,466	$48,648	$41,263
Occupancy Expense per employee	$ 3,002	$ 2,208	$ 2,112	$ 2,984	$ 2,475
EDP Expense per Loan Administration Personnel	$ 6,890	$ 4,424	$ 3,920	$ 4,269	$ 4,889
Number of firms	16	48	34	26	124

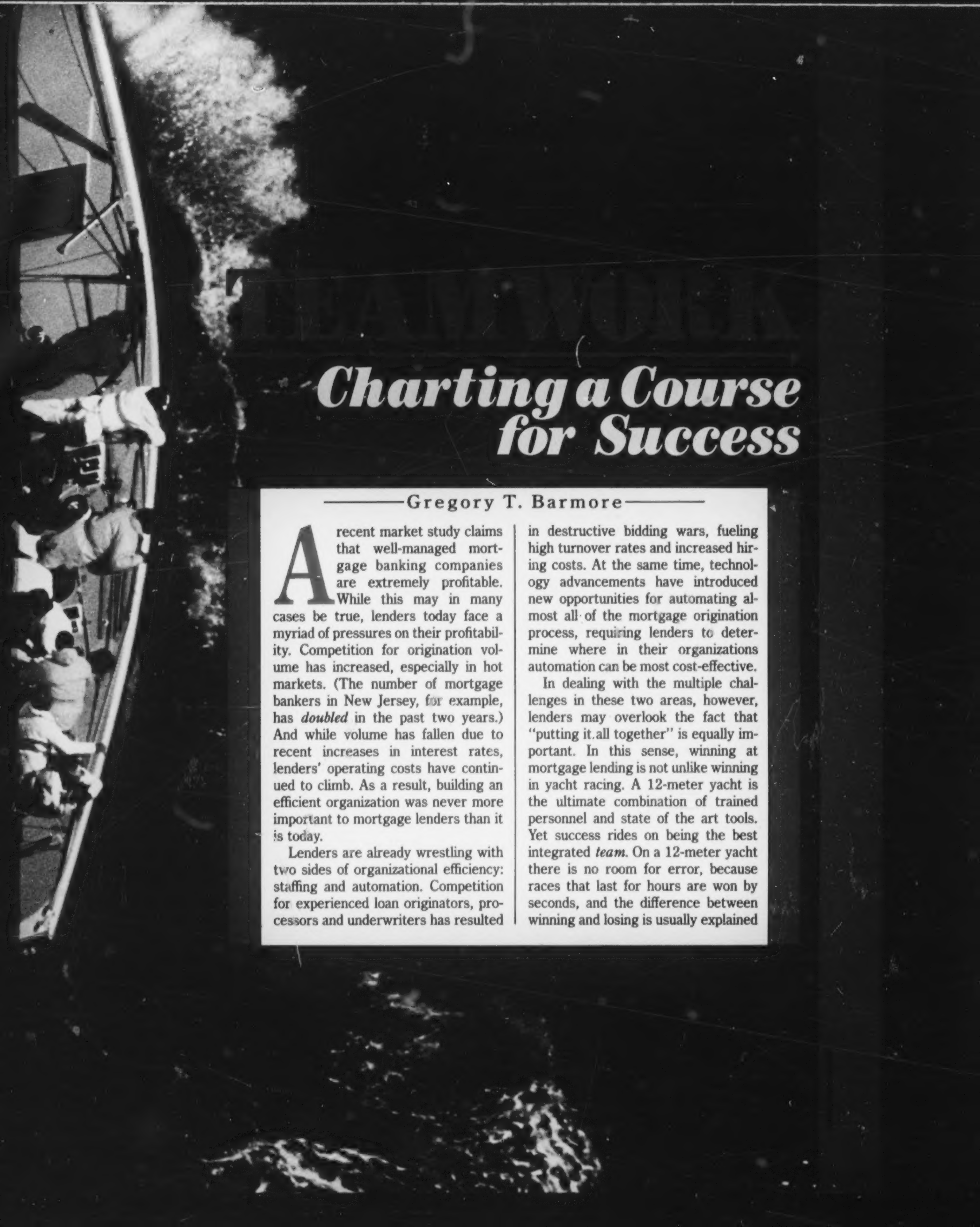
Geographic Regions



the future. Thus, efficient mortgage servicers, especially those who added appreciably to their portfolios from 1986 production, can expect significant improvement in net income in the years ahead. □

The data upon which this study is based was generated by the Mortgage Bankers Association's Mortgage Banking Financial Statements Survey. The 124 respondents to the 1986 survey represent a sizeable portion of the mortgage banking industry, accounting for approximately 40 percent of total single-family originations in this sector. MBA wishes to thank the respondents for their participation.

A more detailed breakdown of the servicing figures, as well as income statements for the single-family loan production, warehousing and marketing operations will be available in the MBA publication, *Income and Costs for Orgination and Servicing of 1 to 4 Unit Residential Loans, 1986* to be released this September.



TEAMWORK

Charting a Course for Success

Gregory T. Barmore

A recent market study claims that well-managed mortgage banking companies are extremely profitable. While this may in many cases be true, lenders today face a myriad of pressures on their profitability. Competition for origination volume has increased, especially in hot markets. (The number of mortgage bankers in New Jersey, for example, has *doubled* in the past two years.) And while volume has fallen due to recent increases in interest rates, lenders' operating costs have continued to climb. As a result, building an efficient organization was never more important to mortgage lenders than it is today.

Lenders are already wrestling with two sides of organizational efficiency: staffing and automation. Competition for experienced loan originators, processors and underwriters has resulted in destructive bidding wars, fueling high turnover rates and increased hiring costs. At the same time, technology advancements have introduced new opportunities for automating almost all of the mortgage origination process, requiring lenders to determine where in their organizations automation can be most cost-effective.

In dealing with the multiple challenges in these two areas, however, lenders may overlook the fact that "putting it all together" is equally important. In this sense, winning at mortgage lending is not unlike winning in yacht racing. A 12-meter yacht is the ultimate combination of trained personnel and state of the art tools. Yet success rides on being the best integrated *team*. On a 12-meter yacht there is no room for error, because races that last for hours are won by seconds, and the difference between winning and losing is usually explained by the mistakes of the loser. The winner is the one with perfect execution, and that requires top performance from each crew member, aimed at ensuring the team's success.

Building teamwork through corporate goals

Instilling this teamwork mentality in an organization means that each person "buys into" the company's goals. This requires first that clear goals be established based upon consensus from those with responsibility for achieving them—not just top management. For example, branch office staff responsible for marketing new loan programs should have a say in setting related volume objectives. Loan processors who face daily struggles to collect loan package documents should participate in establishing loan turnaround time goals.

Assigning accountability for goals also implies delegating the authority to make decisions that will affect how well these goals are achieved. Companies function most efficiently when people with the most knowledge of an issue or problem are charged with solving it. Improving customer service or streamlining paperwork flows may be best addressed by local office managers, because they have more knowledge of staffing, personnel skills and daily business traffic. Conversely, product development may be most successful when handled centrally (with input from field operations), because of the many financial, marketing and administrative issues involved.

Senior management's role in the goal-setting process is to refine and consolidate specific goals into overall corporate objectives, and to keep the organization focused on its goal of being first across the finish line. (Steven Jobs, founder of Apple Computers, defines a leader as the "keeper and reiterator of a vision.")

Several recent articles claim that successful mortgage bankers do not rely on strategic planning, but instead react quickly and decisively to market opportunities as they arise. However, a General Electric Mortgage Insurance Company (GEMICO) survey conducted last year indicated that lenders do indeed set specific goals within which most activities are focused. Four goals were cited by a majority of the 350 lenders surveyed and is shown in Table 1.

The winner is the one with perfect execution, and that requires top performance from each crew member, aimed at ensuring the team's success.

TABLE 1

Goal	Percent of respondents
Increase market share	79%
Build positive image	75%
Reduce costs	68%
Build market leadership	63%

On the other hand, there was much less agreement among lenders on how to achieve these goals; the most popular strategies (targeting specific types of customers, increasing the number of branches, developing new products, or automating functions) each were cited by only one-third of the respondents.

As the GEMICO survey illustrates, lender organizations often have apparently conflicting goals (*e.g.*, increasing branch office coverage to expand market share while at the same time reducing costs). This is not a tactical error, but instead a reflection of the market reality that what works in the short run may not be the best recipe for long-term success. Forward-looking organizations are those that see *both* short and long term, and senior management must foster this perspective at all organizational levels.

Once goals are established, it is important to identify each person's role in achieving them and communicate this throughout the organization. The purpose of this step is twofold: It emphasizes the fact that every individual must be a top performer if the company is to succeed, and it builds appreciation for others' roles in the team's effort. Anyone who has searched in vain for a loan file appreciates a file clerk's contribution to company efficiency. Anyone who has ever been put on hold while making a phone call recognizes how important receptionists are in providing good customer service. However, these contributions are frequently overlooked when things are running smoothly, and similar contributions by other personnel (branch managers, information systems staff, secretaries, etc.) may be less noticeable—at least until they are no longer there.

Periodically measuring the company's performance against its objectives, and communicating the findings to the individual team members is also critical. In this way, management's commitment to attaining these goals is made clear. At the same time, this provides a consistent standard against which all efforts can be measured. Most importantly, this affirms or strengthens individual team members' acceptance of company goals. Imagine again the 12-meter yacht with every crew member except the captain wearing a blindfold. Even if each person could accomplish his assigned task, think how much more motivated the team would be if it could see where competitors' yachts were and knew the distance to the finish line.

Fostering continued teamwork

Once corporate goals are accepted, management must continue to motivate and compensate employees in a manner that fosters teamwork. First and foremost, this means promoting open communication among all levels in the organization, and particularly between different functions. While it is critical that each team member embrace common goals, this does *not* mean that everyone will always agree on how things should be done. For example, lenders entering new markets can do so either by expanding their branch office network or developing correspondent relationships.

Similarly, employees on the "front line" should be encouraged to keep management informed on developing problems and opportunities, so that responses can be implemented

Gregory T. Barmore is president of GE Mortgage Insurance Companies.

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promptly. For instance, GEMICO recently revised its underwriting guidelines on condominiums and investment properties in Colorado based upon recommendations from the local sales representative and branch manager. After their discussions with lenders, appraisers and Realtors confirmed their suspicions about growing problems with these properties, employees suggested policy changes that reduce the excess risk GEMICO accepts on these products while continuing to meet market needs.

This kind of initiative is unlikely to occur unless compensation plans designed to award top performers can also be structured to promote teamwork. For example, traditional incentive plans at GEMICO compensated sales representatives based upon business volume obtained, with underwriter personnel paid on a regular wage basis. While this ensured that each group performed their assigned tasks well, it also promoted an "us versus them" mentality. As long as business volume and quality were relatively high, this attitude did not significantly impair efficiency. However, when branch office turnover temporarily affected service levels or the quality of loans submitted by a specific lender deteriorated, this protectionist attitude actually *slowed* resolution of the problem.

Now, GEMICO sales personnel are paid based upon both business volume and quality, and underwriting managers receive bonuses based upon customer service levels, delinquency measurements and knowledge of local market conditions. In addition, yearlong promotional campaigns are conducted for teams of sales and operations employees at each GEMICO insurance service center, with winning teams receiving free trips to various locations. This year, teams will be measured on underwriting quality, lender quality, local economic market knowledge, customer service levels and new business generated. Based upon results of previous contests, the costs for the winning trips are small compared to the financial gain GEMICO earns from added volume and business quality. Even greater is the increase in motivation exhibited by contest winners—they return from their trips determined to win again the following year.

Lenders are already wrestling with two sides of organizational efficiency: staffing and automation.

GEMICO's experience in its Seattle office dramatically illustrates the benefits realized by creating a teamwork mentality. During 1985, GEMICO's market share in Washington hit an all-time low, and delinquencies and loan declinations skyrocketed due to deteriorating business quality. At the beginning of 1986, faced with the prospect of withdrawing from the state, GEMICO's branch manager and newly-hired experienced sales representatives began to work together to turn the situation around. First, everyone agreed that their goal would be to increase the volume of quality business received from Washington lenders. Second, everyone on the team demonstrated a willingness to "wear different hats" to see this task accomplished. Sales reps met with lenders to discuss underwriting problems, and supported (rather than second-guessed) underwriters when loans were declined. At the same time, branch office underwriters accompanied sales reps on customer calls, and loan processors served as unofficial customer service reps. The result: GEMICO market share in Washington has more than doubled, while loan declinations have been cut in half and delinquency rates have dropped from 3.05 percent to 2.52 percent, lower than the average for all mortgage insurers.

Building teamwork with other industry participants

Mortgage lenders do not operate in a vacuum. Instead, they rely on other industry players to provide business referrals (Realtors) and specific services and products (appraisal companies, mortgage insurers, attorneys, etc.). Because *lender* resources must be used to convert referrals into loan applications, to prepare mortgage insurance application packages, to evaluate appraisals, to service loans, and so on, improving teamwork with other players can also improve a lender's internal efficiency.

GEMICO has taken this approach as part of its customer management strategy. If, for example, delinquency experience with a specific lender deteriorates, GEMICO does not respond by automatically cutting the lender off for future business or start looking for ways to deny claims on technicalities. Instead, GEMICO personnel try to work with the lender to identify both the problems and possible solutions. In some cases, sales representatives or underwriters have conducted loan processing seminars to help train inexperienced lender employees. In other cases, GEMICO has operated as a consulting service by working directly with lenders' servicing departments to help improve collection techniques and identify alternatives to foreclosure (such as modification on high couponrate loans). The resulting improvement in loan package quality or claims mitigation more than offset GEMICO's cost in providing these services, and at the same time an ongoing productive relationship with the customer was established.

Lenders have a significant opportunity to improve internal efficiency by working closely with Realtors, whose influence in the loan origination process is growing more pronounced. A recent Mortgage Bankers Association (MBA) study among Realtors disclosed that 90 percent are involved in many aspects of the financing process: from explaining various loan options and prequalifying borrowers to actually recommending specific lenders as sources of financing. Clearly, how well Realtors perform these tasks will directly influence the level of lender effort required to turn a loan referral into a closed loan. Therefore, lenders must keep Realtors informed not only on prevailing mortgage interest rates, but also on new loan programs being introduced, changing loan documentation requirements, or revised borrower qualification requirements.

Lenders will benefit in two ways from this effort. First, by ensuring that borrower referrals more closely meet lender requirements, loan processing time and effort will be shortened. Second, the solidified business relationship with a Realtor should increase the volume of loan referrals, because the MBA study has shown that Realtors view lender responsiveness, salesmanship, and reputation as important as loan interest rates when making a recommendation.

GEMICO is also working to improve its ability to work with Realtors, because their actions indirectly affect business volume and quality as well. GEMICO has created a "Mortgage Insurance Update for Realtors" package, consisting of three brochures detailing basic information on mortgage insurance, the underwriting approach to 95 percent loan-to-value mortgages, and GEMICO's new premium financing plan that is competitive with FHA's program. These brochures also outline key points that should be conveyed to potential homebuyers, thereby improving the Realtors' ability to serve their customers. In addition, GEMICO sales and underwriting personnel are conducting mortgage insurance information/education sessions with various Realtor boards and agencies, frequently in conjunction with lenders. This Realtor campaign was not devised as a short-term project, but rather an ongoing element of business, because it is perceived that improved teamwork with Realtors will enhance GEMICO performance.

The challenges of turning talented individuals and sophisticated technologies into a smooth-sailing company are many. Creating a focus on teamwork can be accomplished by establishing clear goals based upon the consensus of those charged with achieving them, defining the role each employee will play in reaching chosen objectives, motivating and compensating personnel based upon complementary (rather than contradictory) standards, and measuring and providing feedback on team performance. In addition, significant opportunities exist for fostering teamwork with other industry players who share lenders' goal of promoting homeownership. Lenders who succeed in building a well-integrated team have their 12-meter yacht on the right tack for capturing their own America's Cup. ☐

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MORTGAGE MARKET TRENDS

Recent economic indicators suggest that GNP growth will slow substantially in the second and third quarters from the robust first quarter pace. For example, payroll employment and aggregate hours worked in the second quarter increased at much slower rates than in the first quarter.

Several components of GNP will account for the slowdown. Inventory investment and residential investment are expected to slow markedly or decline. Real personal consumption expenditures, which account for about two-thirds of the GNP, will increase only moderately. While these components of GNP are likely to contribute to slower growth, net exports is expected to show continued improvement. The improvement partially reflects previous changes in the exchange value of the dollar. Improvement in real net exports started in the fourth quarter of 1986, continued in the first quarter, and will act as an important element of strength to the economy in the second and third quarters.

The sluggishness of the economy has helped keep a lid on inflation. Increases in both producer prices and consumer prices have moderated in recent months after a temporary surge in oil, food, and import prices pushed up the inflation rate earlier this year. Producer prices of finished goods increased only 0.3 percent in May and 0.2 percent in June, and, excluding the volatile food and energy components, showed little change in May and June. Similarly, the May increase in the consumer price index was only 0.3 percent—the smallest monthly increase this year. These recent statistics support the view that the inflation rate is unlikely to accelerate above 4 to 5 percent this year.

The sluggishness of the economy and moderate inflation have helped stabilize bond prices in recent weeks. Several factors will play an important role in credit markets in the months ahead: the exchange value of the dollar, the stance of monetary policy, the federal budget deficit and inflation expectations.

These factors are interrelated. Until the recent recovery of the dollar against the yen and the West German mark, there was growing market sentiment that rising import prices would cause an acceleration of inflation and would force the Federal Reserve to tighten credit further to bolster the dollar. These fears have now been allayed. With the sluggish economy, a rebounding dollar, and moderate inflation, the Federal Reserve has more flexibility in providing an accommodative monetary policy.

The federal budget deficit remains a problem. Rapid growth in federal debt due to large deficits continues to flood credit markets with government securities, keeping interest rates higher than they otherwise would be. The mid-session review of the federal budget this summer will once again focus attention on the outlook for the deficit. The deficit will decline substantially in fiscal year 1987, probably to around $165 billion, but it may be difficult to make further progress in fiscal year 1988.

With heavy credit demands from the federal government likely to continue, large capital inflows from abroad will be needed to keep interest rates from rising. A stronger exchange value of the dollar is important in this respect. If the dollar is expected to increase in value, foreign investors are more likely to invest in U.S. securities because they will profit from both the relatively attractive returns on U.S. securities and currency appreciation.

Finally, inflation expectations will play a critical role in the determination of nominal interest rates. The strengthening of the dollar has served to dampen inflation expectations. However, movements in oil prices remain a possible concern. If tensions in the Middle East escalate, threaten the supply of oil, and sharply increase oil prices, inflation expectations would rise as a result and drive up nominal interest rates. Hopefully, this will not happen. In any event, the prospects for relatively stable interest rates seem greater than a few weeks ago.

Thomas M. Holloway
Senior Economist
July 10, 1987

HOUSING ACTIVITY
RESIDENTIAL STRUCTURES, BY UNIT TYPE
(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
DEC	114	80	34	1,813	1,341	472	132	82	50	1,862	1,289	573
1987												
JAN	105	75	30	1,816	1,332	484	102	69	33	1,652	1,181	471
FEB	103	76	27	1,838	1,379	459	101	76	25	1,676	1,313	363
MAR	141	107	34	1,730	1,296	434	150	109	41	1,719	1,244	475
APR	162	126	36	1,620	1,287	378	157	117	40	1,598	1,152	446
MAY$_p$	160	121	39	1,665	1,204	416	135	104	31	1,477	1,097	380
1986 TOTAL	1,806	1,263	543				1,769	1,185	584			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
5 MONTHS												
1987	670	504	166				647	477	170			
1986	749	514	235				735	486	249			
1985	691	472	219				687	440	247			
1984	730	510	220				727	474	253			

RESIDENTIAL STRUCTURES BY REGION
(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
DEC	19	19	39	36	309	394	602	508	21	19	43	49	284	303	567	708
1987																
JAN	16	16	44	29	336	431	589	460	14	14	41	29	286	362	568	436
FEB	10	14	45	34	291	371	675	501	15	16	43	27	319	388	577	392
MAR	22	24	57	40	296	348	616	470	25	26	60	41	317	335	624	443
APR	26	29	66	41	275	310	672	408	27	32	58	41	290	305	588	415
MAY$_p$	28	33	61	38	294	316	630	380	26	27	48	33	273	278	562	364
1986 TOTAL	294	296	733	484					283	290	687	510				
1985 TOTAL	252	240	782	468					260	237	753	484				
5 MONTHS																
1987	101	115	272	182					108	114	251	174				
1986	104	103	335	207					103	108	312	211				
1985	83	83	333	193					98	82	314	194				
1984	63	83	391	194					73	80	371	203				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
DEC	268	49	357	5.8	227.3	107.4	30.2	89.7	1,104	658	446	175	120	55
1987														
JAN	216	53	358	6.2	222.4	107.9	29.4	85.1	1,089	658	431	137	91	46
FEB	241	59	358	6.1	224.5	108.5	28.4	87.6	1,096	669	427	118	78	40
MAR	325	72	358	6.1	225.9	112.0	27.5	86.4	1,085	669	416	127	86	41
APR	331	71	360	5.9	225.0	112.9	27.1	85.0	1,075	676	399	135	94	41
MAY$_p$	344	58	356	7.1	227.8	113.1	28.4	86.3	1,081	686	395	130	93	37
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
5 MONTHS														
1987	1,465	314										646	440	206
1986	1,373	363										649	438	211
1985	1,225	295										624	423	201
1984	1,200	293										610	416	194

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
SEP	$58,193	$14,360	$20,289	$20,576	$2,968	$42,621	$12,648	$16,668	$12,870	$435
OCT	56,285	12,659	20,760	19,781	3,085	41,901	11,535	16,992	12,985	389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
DEC	74,941	14,615	26,639	27,478	6,209	47,459	13,148	19,298	14,720	293
1987										
JAN	42,804	9,748	12,888	18,641	1,527	31,397	8,791	10,453	11,932	221
FEB$_p$	44,756	10,518	13,128	19,103	2,007	31,486	10,012	10,773	10,534	167
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
2 MONTHS										
1987	87,559	20,266	26,016	37,743	3,534	62,884	18,803	21,226	22,467	388
1986	53,813	11,323	20,990	18,215	3,285	35,286	10,494	16,050	8,509	233
1985	40,695	7,827	15,863	14,675	2,330	26,393	7,468	11,340	7,483	102
1984	41,319	9,180	15,539	14,878	1,722	27,059	7,540	11,563	7,866	90

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
SEP	$4,769	$1,326	$1,897	$1,312	$234	$10,803	$386	$1,724	$6,394	$2,229
OCT	3,560	735	1,933	735	157	10,824	389	1,835	6,061	2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
DEC	6,753	919	3,629	1,677	528	20,729	548	3,712	11,081	5,388
1987										
JAN	2,868	529	1,330	877	132	8,539	428	1,105	5,832	1,174
FEB$_p$	2,664	222	1,149	1,053	240	10,606	284	1,206	7,516	1,600
2 MONTHS										
1987	5,532	751	2,479	1,930	372	19,143	712	2,311	13,346	2,774
1986	4,187	409	2,317	1,036	425	14,340	420	2,623	8,670	2,627
1985	2,705	61	1,614	795	235	11,597	298	2,909	6,397	1,993
1984	3,753	890	1,677	991	195	10,507	750	2,299	6,021	1,437

LONG-TERM COMMITMENT ACTIVITY
By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
SEP	$48,050	$11,297	$19,442	$15,024	$2,287	$159,746	$25,320	$51,957	$62,601	$19,868
OCT	43,470	8,959	19,202	12,593	2,716	138,410	17,784	49,878	51,605	19,143
NOV	35,692	8,263	17,111	7,554	2,764	129,766	20,974	48,994	40,726	19,072
DEC	43,851	13,033	19,548	7,979	3,291	124,202	23,189	43,014	41,809	16,190
1987										
JAN	29,909	7,044	13,718	6,674	1,663	116,720	18,703	40,419	41,594	16,004
FEB$_p$	34,416	10,941	11,585	9,599	2,291	137,452	20,664	49,401	51,121	16,266
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
2 MONTHS										
1987	63,515	17,985	25,303	16,273	3,954					
1986	59,191	15,649	26,820	11,708	5,014					
1985	38,761	7,454	19,971	7,172	4,164					
1984	37,648	8,640	19,650	6,405	2,953					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
DEC	215	111	39	65	176	$12,313	88	$5,531	39	$2,768	49	$4,014
1987												
JAN	208	120	41	47	176	12,234	96	5,955	38	2,718	42	3,561
FEB	243	153	42	48	168	11,587	91	5,520	44	3,255	33	2,812
MAR	307	190	49	68	248	16,979	149	9,220	60	4,420	39	3,339
APR	285	165	41	79	229	15,857	144	9,036	41	3,021	44	3,800
MAY$_p$	n.a.	n.a.	38	74	230	15,838	149	9,265	36	2,622	45	3,951
1986 TOTAL	3,283	1,908	452	923	1,770	122,474	839	51,616	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
5 MONTHS												
1987	n.a.	n.a.	211	316	1,051	66,495	629	38,996	218	16,036	203	17,462
1986	1,405	967	114	324	568	38,835	267	16,456	102	7,208	199	15,171
1985	824	316	84	424	467	30,116	113	6,400	65	4,228	289	19,488
1984	823	214	95	514	571	36,270	103	5,459	99	6,389	369	24,422

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
DEC	1,272	2,336	97,174	5,494	7,993	8,742	11,306	11,579	10,377	12,123
1987										
JAN	948	1,346	101,687	6,363	7,294	8,003	7,950	8,215	13,932	10,624
FEB	912	979	104,670	4,691	8,503	7,990	7,961	7,844	11,668	9,692
MAR	2,805	1,435	107,673	4,627	9,003	14,314	9,394	9,145	10,873	10,736
APR	3,208	2,118	112,673	6,997	n.a.	n.a.	n.a.	n.a.	15,050	11,934
MAY$_p$	1,726	1,718	116,861	7,086	n.a.	n.a.	n.a.	n.a.	10,220	3,515
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
5 MONTHS										
1987	9,599	7,595	—	29,764	24,800	30,307	23,305	25,204	61,743	46,501
1986	13,122	7,366	—	16,528	25,842	28,346	19,827	19,061	49,127	28,135
1985	8,825	8,975	—	6,680	14,644	15,480	10,877	9,498	20,814	14,279
1984	8,123	7,958	—	4,836	6,025	6,430	5,081	3,907	15,862	12,995

*Year-to-date totals are for three months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1987								
JAN	8.79%	9.09%	9.10%	9.51%	9.53%	8.31%	8.815%	10.81%
FEB	8.81	9.04	9.04	9.23	9.21	8.48	8.668	10.25
MAR	8.94	9.19	9.20	9.14	9.09	8.06	8.633	10.24
APR	10.02	10.11	10.14	9.21	9.09	8.35	9.655	12.08
MAY	10.61	10.44	10.46	9.37	9.27	8.85	10.208	12.65
JUN$_p$	n.a.	n.a.	n.a.	9.5	9.42	8.69	9.995	n.a.

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1987							
JAN	8.22%	8.31%	8.26%	8.92%	7.08%	5.44%	5.84%
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05
MAR	8.12	8.25	8.22	8.84	7.25	5.59	6.16
APR	9.06	9.13	9.08	9.51	8.02	5.90	6.45
MAY	9.76	n.a.	n.a.	10.05	8.61	6.05	6.93
JUN	9.69	9.70	9.65	10.05	8.4	5.99	6.92

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1987				
JAN	−13	114	123	118
FEB	−1	81	96	92
MAR	10	87	100	97
APR	51	104	111	106
MAY	56	115	n.a.	n.a.
DEC	n.a.	129	130	125

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

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MORTGAGE BANKING

SEPTEMBER 1987

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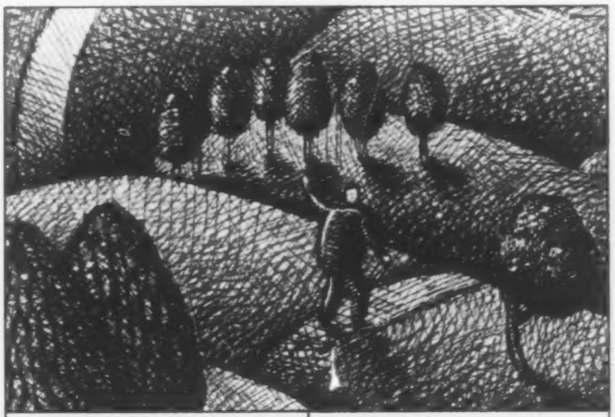
MORTGAGE BANKING



ARTICLES

PAGE 8
THRIFTS: STRONG, TROUBLED AND IN FLUX
AN INTERVIEW WITH THE CHAIRMAN OF THE NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

In this exclusive interview, John Morgan, the chairman of the National Council of Savings Institutions shares his insights on the future of the thrift industry and identifies his goals for his year as chairman.

PAGE 18
INSTITUTIONAL INVESTMENT TODAY: THE ENDURING FINANCIAL GIANTS
Kevin Starr and Jim Miselis

Institutional investors are more cautious and quality-conscious today. There is more emphasis on project cash flows and pre-tax yields with the new tax law in effect. According to this article, the institutional real estate investment environment is still favorable.

PAGE 31
FDIC AND FSLIC: TWO PARTS OF ONE INDUSTRY?
L. William Seidman

Together the FDIC and FSLIC would be a formidable fource that could achieve results. According to the chairman of FDIC, the two institutions have much on which to confer. Both have common interests in being competitive, having safe and credible insurance funds and being major fund gatherers in the economy.

PAGE 38
FADA UPDATE: THE ASSET MOVERS
Roslyn B. Payne

FADA is managing approximately 2,500 assets for 31 troubled S&Ls valued at almost $5.2 billion. FADA now has enough experience to know where and what type of property it can package and market aggressively.

PAGE 54
FOLLOWING THE LEAD OF YOUR PENSION FUND ADVISOR
S. Q. Della Grotta

Mortgage bankers who seek to be successful in making deals with pension funds need to become familiar with the pension fund universe. A real estate advisor can help in structuring submissions and explaining investment criteria.

PAGE 65
BUSINESS BASICS
MORTGAGE CORRESPONDENTS: LOCAL EYES AND EARS
John Oharenko and Anatole Kolomayets

Many major life companies are choosing to establish regional offices that are capable of arranging loans with developers on a direct basis and are bypassing the mortgage banker. This article details reasons why these changes are occurring.

PAGE 70
ELDERLY HOUSING: HOME SWEET HOME TO STAY
Dr. William C. Apgar, Jr.

Many elderly are well housed and happy. Developers and real estate investors need to do market research so they can serve the needs of the elderly better. Home repair, a rehab market, and an elderly home services market need to be offered to the aging.

PAGE 71
ELDERLY HOUSING: AGING IN COMFORT
Eugene Lehrmann

Housing is a basic human need and too many Americans, including the elderly, lack even the most basic shelter. But mortgage bankers have a critical role to play in meeting the housing needs of older Americans.

PAGE 82
HOUSING OF THE 1980s: UNAVAILABLE, UNAFFORDABLE AND INDECENT
Dr. Richard W. Peach

According to this article, housing costs are rising faster than income for an expanding segment of our society. Affordability, a problem largely concentrated among lower-income households, is increasingly becoming a problem for middle-income families as well.

PAGE 97
MAXIMIZING YOUR SERVICING PORTFOLIO: HANDLING THE GYRATING MARKET
Hunter Wolcott

Servicing has usually been thought of as the "riskless" component of mortgage banking. Changes in the financial markets, however, have altered this perception. Managing a servicing portfolio now requires the highest level of skill.

PAGE 111
WHAT'S NEW WITH REMICs AND CMOs: THE DEVELOPING MARKET FOR RESIDUALS

Part 1 in a series of articles on mortgage residuals focuses on the development of the residual market and performance economics and sources of residual cash flow.

DEPARTMENTS

ABOUT THE ISSUE 3
BUSINESS BASICS 65
PEOPLE 120
BOOKS 126
SECONDARY MORTGAGE MARKETS 131
MORTGAGE MARKET TRENDS 133
AD INDEX 142

FADA UPDATE

THE ASSET MOVERS

Roslyn B. Payne

When the Federal Home Loan Bank Board created the Federal Asset Disposition Association (FADA) on November 5, 1985, the Federal Savings and Loan Insurance Corporation (FSLIC) held more than $2.5 billion in book value of assets in 26 defunct savings institutions or receiverships. Now 18 months later, the book value of total assets held has grown 200 percent or to approximately $7.4 billion in 61 receiverships as of June 30, 1987.

A year ago there were four criteria for FADA to be judged against with respect to performance:

- FADA's ability to handle large volumes of these difficult assets;
- The variety of problems that will need to be resolved;
- The way FADA will go about solving problems; and
- Asset recoveries and reserve recaptures.

How has FADA done so far?

Volume and variety

On July 18, 1986, FADA received its first asset management assignment from FSLIC. FADA was assigned 64 assets with a book value of $131 million from Sun Savings and Loan, a failed savings institution in San Diego, California.

Almost a year later, FADA is managing approximately 2,500 assets for 31 troubled S&Ls valued at approximately $5.2 billion,[1] as of May 31, 1987. In addition, FADA is performing asset advisory work for 12 financially troubled institutions with approximately 500 assets under contract to FSLIC and advising FSLIC on nine assignments ranging from nationwide participation loan problems to portfolio analysis involving a real estate syndication subsidiary of a saving institution.

In the area of volume, FADA has been able to work successfully on large numbers of assets even during a start-up year.

The breadth of the problems that troubled institutions are involved in—and that FADA has been called upon to resolve—is truly staggering. How is FADA dealing with this variety of problems?

FADA acts as an agent and never takes title to assets. FADA has continued to act in three capacities:

- Asset management and disposition
- Asset advisory
- Advise FSLIC on a multitude of issues.

During this year FADA has had a few key observations for the portfolios it has been involved with:

- Generally three-quarters of the assets are *loans* not real estate owned (REO). Of the loan category, land loans and construction loans dominate the landscape.
- With respect to property types, land and condominium assets are significant. Retail, office and mixed use range between 10-15 percent each. A far cry indeed from the traditional lines of business for a savings and loan.
- Geography—assets in three states repeatedly occur: Texas, Florida and California. Nearly three-quarters of the value of assets under FADA management are located in the sun and oil belts across America. During the next few years these percentages will change, but FADA anticipates that the states of California, Texas and Florida will continue to dominate the picture.

All of the cases we have seen to date are basically cases of mismanagement and fraud.

Creating FADA's infrastructure

FADA's beginning was evidenced by the funding of $25 million in capitalization from its parent and sole shareholder, FSLIC, on March 14, 1986. The association has grown during the period of one year to be a company that, as of May 31, 1987, operates in six cities across the country with a staff of approximately 248. A real estate operations infrastructure has been built that has three strong elements:

- A regional delivery system in five major cities—Denver, Los Angeles, San Francisco, Dallas and Atlanta—that offers FSLIC and the 12 Federal Home Loan Banks a full range of asset management and disposition services nationwide including professional services focusing expertise in the areas of asset analysis, asset strategy development and asset marketing. FADA's regional apparatus is structured to provide services in a comprehensive manner from assignment to ultimate disposition or provide assistance in an advisory capacity focused on a particular fact of a troubled asset.
- An umbrella approach to managing assets that provides value added to FSLIC in major ways that significantly reduce costs and addresses major asset quality problems. FADA's regional system is supported by six functional areas of expertise based in the San Francisco administrative offices. These areas are: appraisal and valuation services, contractor administration, participations, national marketing, property insurance and risk management and institutional evaluations and advisory services. These

ILLUSTRATION BY TODD TREADWAY

units support the regional network through the development of uniform policies and procedures and implementation methodology that capitalizes on economies of scale and minimizes duplication.

- Asset reporting, systems and controls that enhance the asset management process and preserve the integrity of the policies and procedures built. FADA is linked nationally by a local area network computer system that enables FADA to report and control the assets assigned from FSLIC in a timely and accurate environment. This allows FADA to position itself to act rather than react to changed circumstances or environment.

Capital recovery

Sale and loan workout accomplishments—Since its inception until May 31, 1987, for failed thrift assignments, FADA has closed sales and completed payoffs on 28 assets at a net takeover value of $36 million, and has 46 sales and loan payoffs under contract totalling $62 million. FADA has 79 additional sales and loan payoffs under negotiation representing $220 million in net takeover value. Loans restructured for failed thrifts to date equal $29 million in net takeover value, while loan restructures under negotiations amount to $591 million.

With respect to asset advisory engagements, FADA has restructured 21 loans valued at $243 million, completed or has under negotiation 11 sales, loan payoffs or deeds in lieu of foreclosure with a value of $59 million. This excludes several companies that FADA is managing and will eventually market.

Sales and loan payoffs or loan restructures under contract or negotiation for asset management services for supervised associations total 60 with a value of $220 million.

FADA has or is restructuring and selling in excess of 400 assets valued at nearly $1.5 billion as of May 31, 1987.

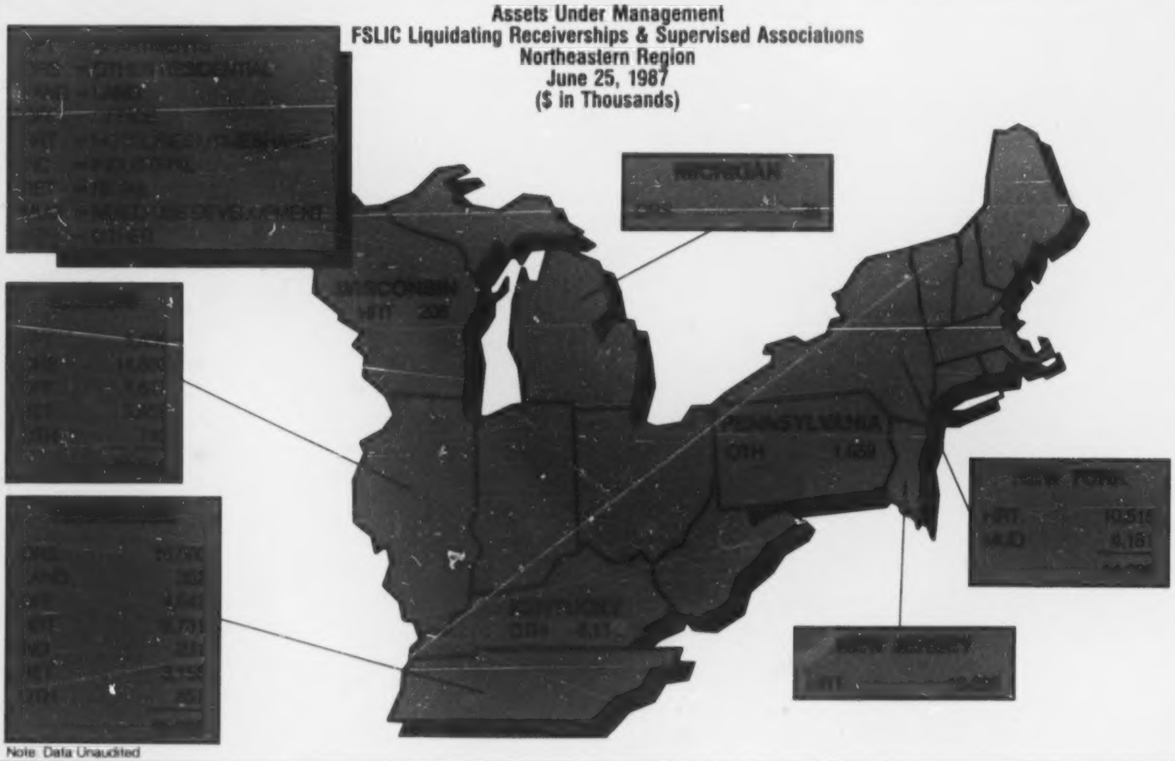
continued

Almost a year later, FADA is managing approximately 2,500 assets for 31 troubled S&Ls valued at approximately $5.2 billion.

Roslyn B. Payne is president and chief executive officer of the Federal Asset Disposition Association in San Francisco, California. FADA is owned by the Federal Savings and Loan Insurance Corporation. The association was created in late 1985 to handle the management, workout and liquidation of the significant number of difficult assets encountered by FSLIC through the failure of savings institutions. FADA acts as an agent for FSLIC.

EXHIBIT 1

Federal Asset Disposition Association



Assets Under Management
FSLIC Liquidating Receiverships & Supervised Associations
Northeastern Region
June 25, 1987
($ in Thousands)

Note Data Unaudited

FADA continues to focus on the bottom line: capital recovery. The reason for FADA's existence is to achieve maximum dollar for FSLIC.

Capital recovery estimates

The area where the FADA can be of the most "added value" to the system is in the area of "capital recovery" relative to the disposition of assets for FSLIC. Capital recovery is and will continue to be one of the key areas of FADA's focus. For illustrative purposes, for each 10 percent improvement on $100 million of FADA managed assets, a $10 million benefit would be realized for FSLIC.

As an example, during the third quarter of 1986, FSLIC asked FADA to manage three major portfolios. These portfolios emanated from the Sun, Presidio and Sunrise receiverships. To date, progress on these portfolios has been encouraging.

Based on the most recent FADA analysis of the three portfolios, a 90 percent plus or minus recovery rate is anticipated. However, when the combined portfolios are examined, it must be recognized that many of the markets in which these assets are located are extremely volatile and that future economic changes could cause significant fluctuations in asset values, which in turn would influence recovery.

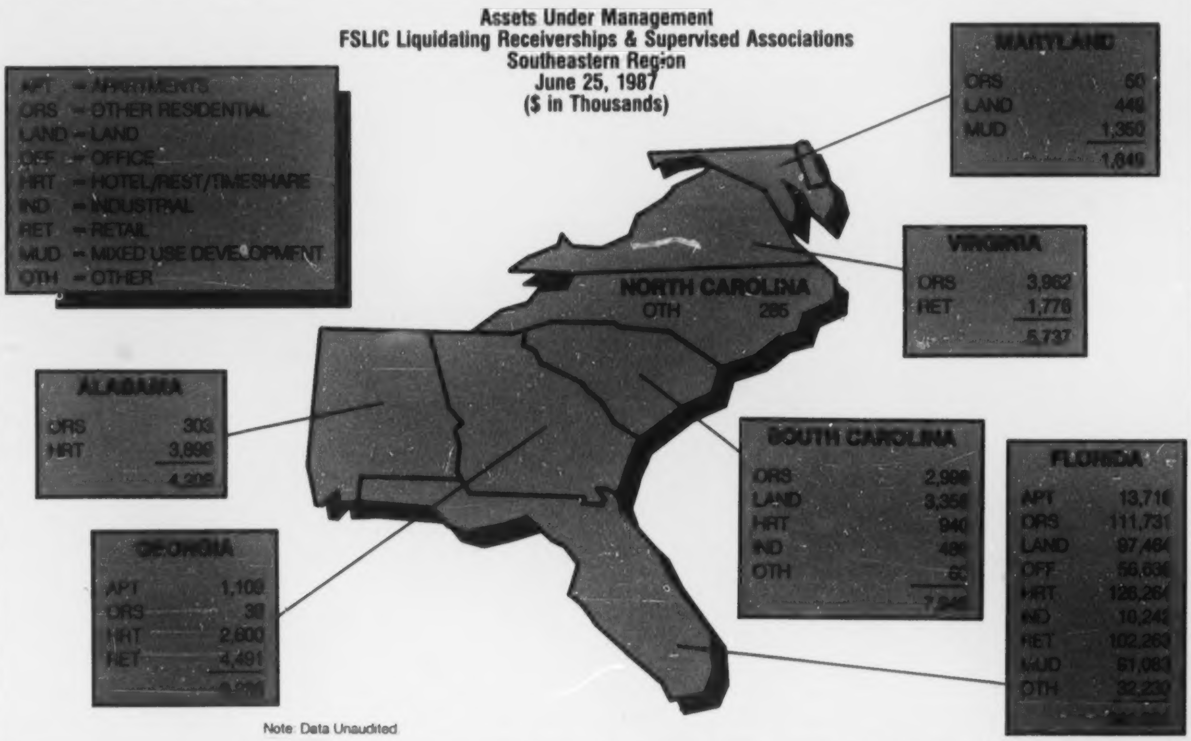
An example of a successful major loan workout is the recent global swap negotiated by FADA between two California savings and loans (Thrift A and Thrift B). FADA, in connection with its management of Thrift A's asset portfolio, recently completed a global workout of 23 participation assets with an original book value of $27 million between Thrifts A and B. The swap will take the second thrift out of the lead management position of these assets, allowing significantly greater ease in the management and liquidation of them. The two S&Ls' shares in each of the assets were equated and partial shares were "swapped" for whole assets. The high costs involved in managing a participation loan are alleviated for both parties. Substantial fees related to legal and management services have been eliminated.

A second example of a successful loan workout and sale involved a large land corporation in Florida. A $26 million loan was made by the institution to the land corporation for the development of 860 acres in North Tampa, Florida, as a planned unit development

continued

EXHIBIT 2

Federal Asset Disposition Association



Assets Under Management
FSLIC Liquidating Receiverships & Supervised Associations
Southeastern Region
June 25, 1987
($ in Thousands)

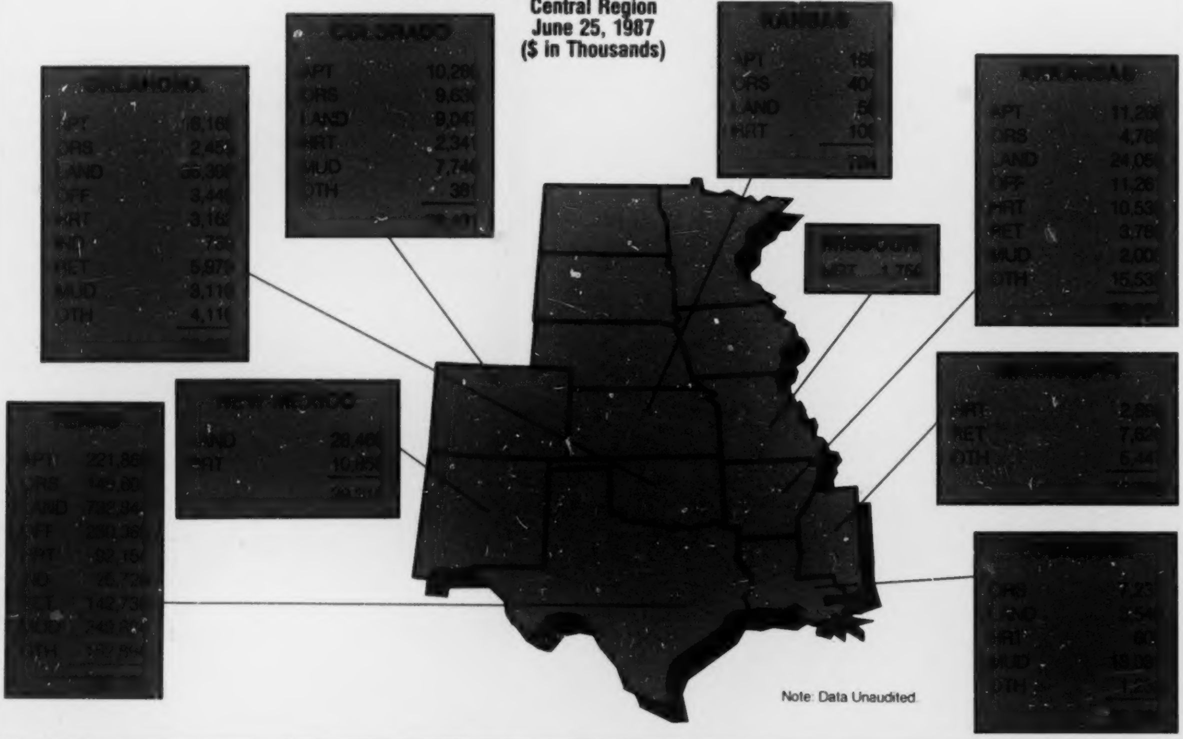
APT = APARTMENTS
ORS = OTHER RESIDENTIAL
LAND = LAND
OFF = OFFICE
HRT = HOTEL/REST/TIMESHARE
IND = INDUSTRIAL
RET = RETAIL
MUD = MIXED USE DEVELOPMENT
OTH = OTHER
MARYLAND
ORS 60
LAND 449
MUD 1,350
1,849
VIRGINIA
ORS 3,962
RET 1,776
5,737
NORTH CAROLINA
OTH 285
ALABAMA
ORS 303
HRT 3,899
4,202
GEORGIA
APT 1,109
ORS 30
HRT 2,600
RET 4,491
SOUTH CAROLINA
ORS 2,998
LAND 3,358
HRT 940
IND 489
OTH 60
7,845
FLORIDA
APT 13,710
ORS 111,731
LAND 97,464
OFF 56,636
HRT 126,264
IND 10,242
RET 102,263
MUD 61,083
OTH 32,230

Note: Data Unaudited

EXHIBIT 3

Federal Asset Disposition Association

Assets Under Management
FSLIC Liquidating Receiverships & Supervised Associations
Central Region
June 25, 1987
($ in Thousands)



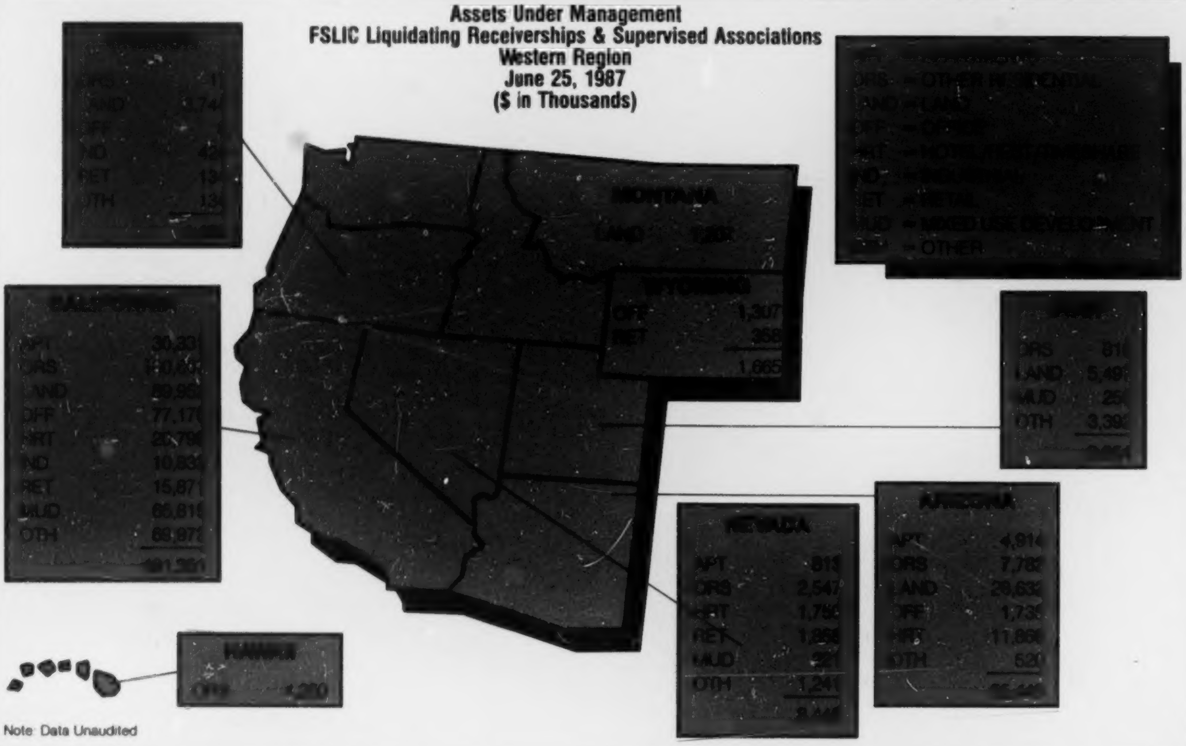
COLORADO
APT 10,28
ORS 9,63
LAND 9,04
HRT 2,34
MUD 7,74
OTH 38
KANSAS
APT 16
ORS 40
LAND 5
HRT 10
ARKANSAS
APT 11,26
ORS 4,78
LAND 24,05
OFF 11,26
HRT 10,53
RET 3,76
MUD 2,00
OTH 15,53
APT 8,16
ORS 2,45
LAND 56,30
OFF 3,44
HRT 3,16
IND 73
RET 5,97
MUD 3,11
OTH 4,11
MISSOURI
RET 1,75
NEW MEXICO
LAND 28,46
HRT 10,85
APT 221,86
ORS 149,60
LAND 792,94
OFF 280,36
HRT 92,15
IND 25,72
RET 142,73
MUD 243,92
OTH 357,94
HRT 2,88
RET 7,62
OTH 6,44
ORS 7,23
LAND 2,54
HRT 60
MUD 18,08
OTH 1,23

Note: Data Unaudited.

EXHIBIT 4

Federal Asset Disposition Association

Assets Under Management
FSLIC Liquidating Receiverships & Supervised Associations
Western Region
June 25, 1987
($ in Thousands)



ORS 1
LAND 3,74
OFF 1
IND 42
RET 13
OTH 13
ORS = OTHER RESIDENTIAL
LAND = LAND
OFF = OFFICE
HRT = HOTEL/RESTAURANT/RESORT
IND = INDUSTRIAL
RET = RETAIL
MUD = MIXED USE DEVELOPMENT
OTH = OTHER
MONTANA
LAND 1,20
WYOMING
OFF 1,307
RET 358
1,665
CALIFORNIA
APT 30,33
ORS 100,60
LAND 89,95
OFF 77,17
HRT 20,79
IND 10,83
RET 15,87
MUD 65,81
OTH 68,97
491,36
ORS 81
LAND 5,49
MUD 25
OTH 3,39
NEVADA
APT 81
ORS 2,547
HRT 1,75
RET 1,85
MUD 22
OTH 1,24
ARIZONA
APT 4,91
ORS 7,78
LAND 28,63
OFF 1,73
HRT 11,86
OTH 52
HAWAII
ORS 1,20

Note: Data Unaudited

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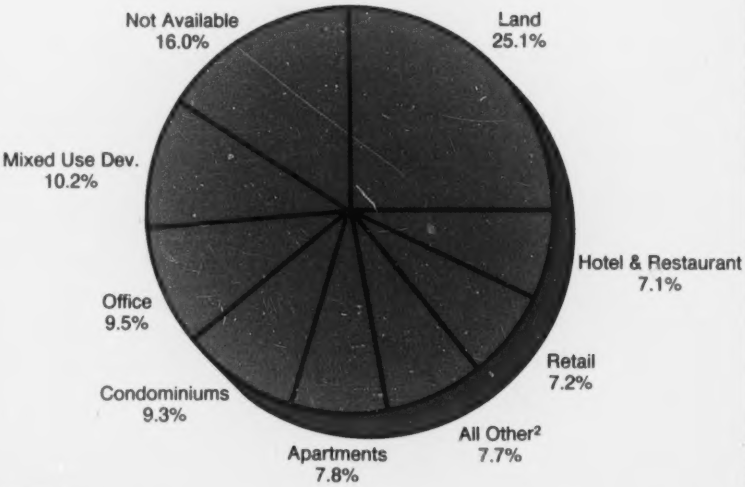
EXHIBIT 5

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Value of Assets by Property Type[1]
As of June 25, 1987

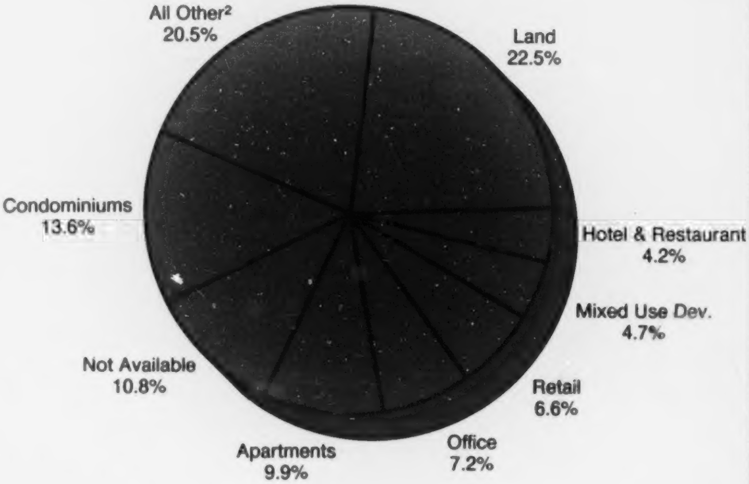


[1] Data Unaudited.
[2] Includes Single-Family, Planned Unit Dev., Timeshare, Industrial, Research & Dev., Special Purpose, Other Real Property and Other Non-Real Property.

EXHIBIT 6

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Value of Assets by Property Type[1]
As of June 25, 1987

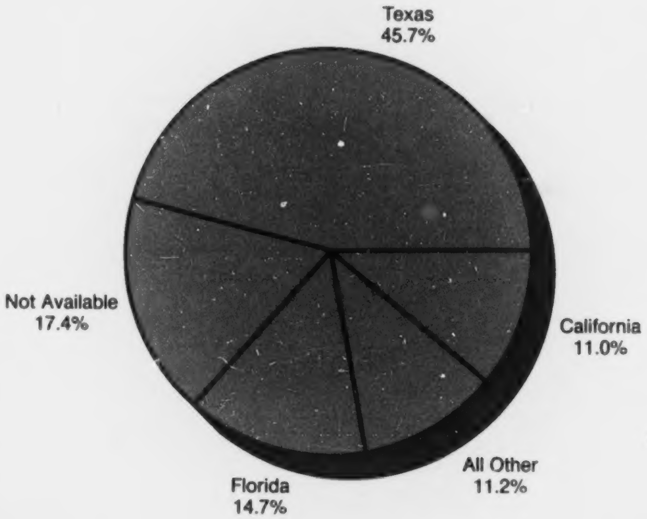


[1] Data Unaudited.
[2] Includes Single-Family, Planned Unit Dev., Timeshare, Industrial, Research & Dev., Special Purpose, Other Real Property and Other Non-Real Property.

EXHIBIT 7

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Value of Assets by State[1]
As of June 25, 1987

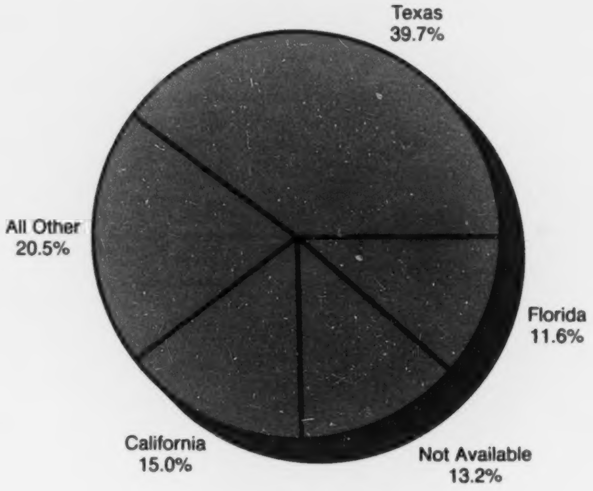


[1] Data Unaudited.

EXHIBIT 8

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Value of Assets by State[1]
As of June 25, 1987



[1] Data Unaudited.

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of high quality single-family homes along with tennis, golf and polo facilities. To date, only the golf course has been completed.

At the time of FADA's involvement a proposal for the sale of the property securing this $26 million loan was proposed on a basis that would have involved the payment of $18 million in case and an $8 million principal loss, in addition to the loss of previously accrued but unpaid interest.

Through FADA's efforts, that sale proposal has been restructured to include the taking of an $8 million second mortgage and additional collateral that will add to the recovery as certain sales levels are attained. A mechanism was also put in place that will assure FADA's ability to get control of the asset on a direct and timely basis, thus short-cutting the lengthy Florida foreclosure process in the event that the purchaser is unable to close as agreed. In addition, the new purchaser will pay the costs incurred by FADA and the receiver in conjunction with documenting and closing this transaction.

This settlement is particularly significant because it enables FSLIC to share in the "upside" of the development, if a value greater than $18 million can be obtained for the property. *FADA's negotiations "added value," in this case, of potentially $8 million.*

Creative marketing

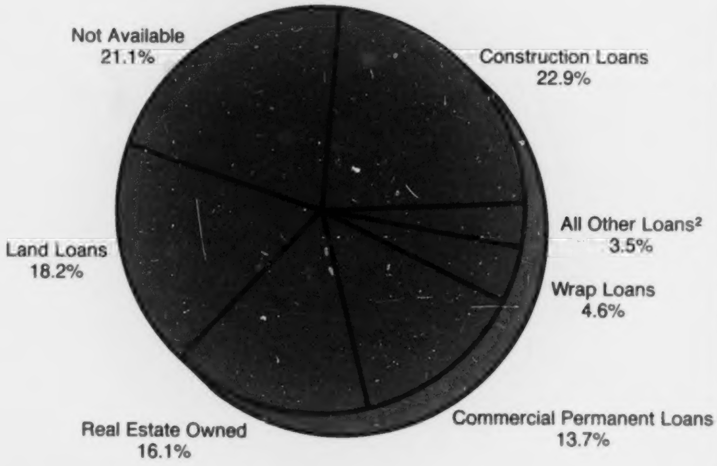
FADA now has enough experience to know where and what type of property it can package and market aggressively. FADA has worked through numerous global settlements with large borrowers and dealt with the litigation roadblocks on other large deals. Additionally, FADA is exploring in a concrete fashion, ways to finance deals using the secondary mortgage market as a vehicle. To do this, FADA is standardizing documents for commercial deals in much the same way Ginnie Mae paved the way for residential mortgage securitization in the early 1970s.

FADA continues to focus on the bottom line: capital recovery. The reason for FADA's existence is to achieve maximum dollar for FSLIC. And, thus far, FADA has achieved that. ☐

EXHIBIT 9

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Value of Assets by Asset Classification[1]
As of June 25, 1987

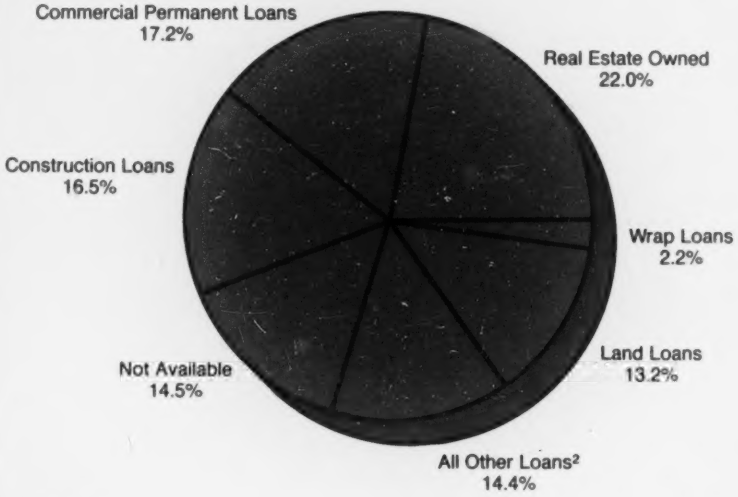


[1] Data Unaudited.
[2] Includes Consumer, Residential Permanent, Acquisition/Development, Unsecured, Acquisition/Development/Construction and Direct Investments.

EXHIBIT 10

Federal Asset Disposition Association

Assets Under Management
(FSLIC Liquidating Receiverships
& Supervised Associations)
Number of Assets by Asset Classification[1]
As of June 25, 1987



[1] Data Unaudited.
[2] Includes Consumer, Residential Permanent, Acquisition/Development, Unsecured, Acquisition/Development/Construction and Direct Investments.

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[1] This reflects 100 percent of value of loans where FADA is managing a lead lender position on participation loans. If 100 percent of the book value of all participation loans is included, the value of assets under FADA management is nearly $6 billion.

HOUSING OF THE 1980s

Unavailable, Unaffordable and Indecent

Dr. Richard W. Peach

At the end of World War II the housing situation in this country was clearly in need of improvement. Fewer than half of all households owned the homes they lived in. "Some 40 percent of the nation's homes . . . were dilapidated or lacked indoor plumbing, and 10 percent of the nation's households lived in overcrowded accomodations."[1]

The passage of the Housing Act of 1949 established as a national goal a general upgrading of the nation's housing stock to culminate in "a decent home and suitable living environment for every American family." The following 30 years witnessed massive investment in housing and supporting infrastructure, fueled by rapid economic growth, relatively stable financial conditions, advances in both housing construction and finance, and government policy that clearly encouraged this investment. The results have been truly dramatic. Roughly 60 percent of all year-round housing units in existence today have been built since 1950.[2] The quality of the housing stock, in terms of its physical condition, amenities and spaciousness, has vastly improved. The rate of homeownership also increased to the point where roughly two of every three households owned the home they lived in. The result has been that "Americans today are the best-housed people in history."[3]

This impressive achievement does not mean, however, that the housing situation is

PHOTOGRAPH: THE BETTMAN ARCHIVE

without problems and that the goal set forth in the Housing Act of 1949 has been achieved. Millions of households continue to live in housing regarded as physically inadequate or overcrowded. Moreover, for an even larger and growing number of households, acquiring physically adequate and uncrowded shelter represents a financial burden.

The measurement of housing problems

A recent study by the Department of Housing and Urban Development (HUD) takes a very close look at the current housing situation based on data from the Annual Housing Surveys (AHS) of 1975, 1977, 1981 and 1983.[4] [5] In this study, as has traditionally been the case, housing problems are separated into two categories, quality and affordability. Housing quality is measured by the physical condition of the housing unit and by the number of people who reside in the unit. Affordability is measured by the extent of financial burden that housing costs impose on the household. In this HUD study, quality and affordability are measured by the following three criteria:

- *Physical inadequacy*—a housing unit is judged to be physically inadequate when plumbing, heating, electrical, sewage, maintenance or public hall defects or flaws exist. A housing unit is judged to be severely inadequate when these defects or flaws are determined to be most serious in terms of health, safety and repair cost.[6]
- *Crowding*—a housing unit is defined as crowded when there is more than one person per room.
- *Cost burden*—a renter is considered to be cost burdened when more than 30 percent of gross household income is devoted to housing costs. (A renter's gross housing cost is gross rent, which includes contract rent plus the cost of utilities and fuels paid by the renter.) A homeowner paying on a mortgage on that property is considered cost burdened if more than 40 percent of gross household income is devoted to housing costs. (A homeowner's housing costs include mortgage principal and interest, real estate taxes, property insurance, utilities, fuel and garbage and trash collection. Maintenance costs are not included.)

Table 1 presents measures of these criteria of housing problems for four years, 1975, 1977, 1981 and 1983. In 1975, 7.7 million or 10.6 percent of the 72.6 million occupied housing units were deemed to be physically inadequate. Of those, 3.1 million or 4.3 percent of the total were severely inadequate. By 1983, physical inadequacy had declined in both absolute terms, down to 7.6 million units, and relative to the total occupied housing stock, down to 8.9 percent. In total, the number of inadequate units declined by 1.8 percent during the eight-year period. The number of units regarded as severely inadequate declined by an even greater percentage, down nearly 8 percent to 2.9 million units or 3.4 percent of the occupied stock.

The homeownership rates for both very low and low-to-moderate income households were lower in 1983 than in 1975 while the homeownership rate for other households, those with middle and upper incomes, was higher.

The incidence of overcrowding declined even more substantially during this period. In 1975, 2.7 million units representing 3.8 percent of the stock met the criterion for overcrowding. By 1983, that number had declined about 19 percent to 2.2 million units or 2.6 percent of the occupied stock.

In contrast, the number of households that were cost burdened rose sharply between 1975 and 1983. In 1975 a total of 8.8 million households were considered to be cost burdened, representing 12.1 percent of all households. By 1983 that number had risen 65 percent to 14.4 million or 17.0 percent of all households.[7] [8]

On balance, the number of households or occupied housing units with a housing problem rose by 26 percent to 24.2 million, more than one-quarter of the total. Declines in physical inadequacy and crowding were more than offset by increases in cost burden. Moreover, by 1983 the number of cost burdened households exceeded the number of physically inadequate and crowded units. Thus, it is clearly the case that affordability has surpassed housing quality as the primary housing problem facing the nation.

Types of physical defects

Data on actual physical defects, presented in Table 2, indicate that the number of housing units lacking basic facilities, such as kitchens, bathrooms and plumbing, has been declining as units lacking such facilities are removed from the housing stock. However, the data also indicate that the incidence of poor maintenance, as evidenced by such defects as plumbing breakdowns, exposed wiring and interior walls, ceilings and floors with cracks and holes, has been increasing.[9] This trend is not inconsistent with the tremendous increase in the incidence of cost burden. For example, homeowners facing affordability problems likely delay or forgo maintenance expenses that they otherwise would incur if their income allowed. Similarly, landlords apparently delay or forgo maintenance expenses that they would be unlikely to recover in higher rents.

The characteristics of households facing housing problems

As shown in Table 3, housing problems are considerably more common among renters than among homeowners. In 1983, 6.2 percent of owner-occupied housing units were physically inadequate compared to 13.8 percent of renter-occupied units. Similarly, 2.2 percent of owner-occupied units were severely physically inadequate while 5.7 percent of renter-occupied units were severely physically inadequate. With regard to crowding, 1.9 percent of owner-occupied units were crowded compared to 4.0 percent of renter-oc-

Richard W. Peach is a senior economist at the Mortgage Bankers Association of America. Prior to joining MBA, he was an economist with the National Association of Realtors (NAR) for 7½ years where he served as staff vice president for forecasting and policy analysis.

cupied units. Moreover, in absolute numbers, crowded owner-occupied units declined by nearly 35 percent from 1975 to 1983 while the number of crowded renter-occupied units increased by 3.4 percent.

This increase in the incidence of crowding among renters is likely due to the high and rising incidence of cost burden. By 1983 roughly one-third of all renter households were cost burdened. The incidence of cost burden among owners in 1983 was much lower—8.4 percent. However, the number of cost burdened owners had increased nearly 80 percent from 1975 to 1983, substantially faster than the rate of increase among renters. Overall, in 1983 half of all renter households experienced some type of housing problem compared to about one of every six owner households.

Affordability has surpassed housing quality as the primary housing problem facing the nation.

This sharp divergence between owners and renters in the incidence of housing problems is attributable to two factors. First, owners have greater control over the physical quality of their residence. If plumbing, heating or some other defect arises, an owner can either fix the problem personally or contract to have the work completed. In contrast, a renter likely would have to call the landlord and request that such problems be corrected.

The second factor is that, as one might expect, the incidence of housing problems, particularly affordability problems, is heavily concentrated among the nation's poorest households, a large proportion of which are renters. As shown in Table 4, very low income households, which made up 27 percent of all households and 43 percent of all renters in 1983, represented about 72 percent of all cost burdened households and occupied about half of all physically inadequate

TABLE 1

Extent of Housing Problems in the U.S.: 1975, 1977, 1981 and 1983[a] (Units in Thousands)

		1975	1977	1981	1983	Percent Change 1975 to 1983
Occupied Housing Units/ Households		72,553	75,399	83,203	84,842	+16.9%
Inadequate Units:	#	7,704	7,641	7,695	7,561	− 1.8%
	%	10.6	10.1	9.3	8.9	—
Severely Inadequate Units:	#	3,123	2,949	2,985	2,876	− 7.9%
	%	4.3	3.9	3.6	3.4	—
Crowded Units:	#	2,742	2,455	2,489	2,230	−18.7%
	%	3.8	3.3	3.0	2.6	—
Cost Burdened Households:	#	8,752	10,101	12,899	14,425	+64.8%
	%	12.1	13.4	15.6	17.0	—
Total Units With Housing Problems:	#	19,198	20,197	23,083	24,216	+26.1%
	%	26.5	26.8	27.8	28.6	—

[a] Major categories of housing problems are mutually exclusive. Crowded units are only those which are physically adequate while households with a cost burden are only those in physically adequate, uncrowded units.

Source of Data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

TABLE 2

Trends in Physical Defects in the Housing Stock: 1975 to 1983 (Units in Thousands)

Basic Facilities	1975		1983		Percent Change
	#	%	#	%	
Kitchen Facilities					
None	1,307	1.8%	714	0.8%	−45.4%
Shared with Another Household	121	0.2%	113	0.1%	−6.6%
Bathrooms					
None	1,845	2.5%	1,672	2.0%	−9.4%
Shared with Another Household	470	0.6%	314	0.4%	−33.2%
Plumbing					
Lacking Some or All Plumbing Facilities	1,883	2.8%	1,538	1.9%	−18.3%
Electrical					
Lacking Working Outlets in Some or All Rooms	2,528	3.5%	2,580	3.1%	2.1%
Heating Equipment					
None	309	0.5%	505	0.7%	63.4%
Maintenance					
Sewage or Septic Tank/Cesspool Breakdowns	102	0.2%	159	0.2%	55.9%
Breakdown in Flush Toilet	156	0.2%	220	0.3%	41.0%
Some or All Wiring Exposed	1,336	1.8%	2,263	2.7%	69.4%
Blown Fuses or Tripped Breaker Switches	1,809	2.7%	3,413	4.3%	88.7%
Breakdown in Heating Equipment	642	1.1%	617	0.8%	−3.9%
Interior Ceilings and Walls With:					
Open Cracks and Holes	3,847	5.3%	5,210	6.2%	35.4%
Broken Plaster	2,518	3.5%	3,178	3.8%	26.2%
Peeling Paint	2,975	4.1%	3,682	4.4%	23.8%
Interior Floors with Holes	1,298	1.8%	1,826	2.2%	40.7%
Signs of Water Leakage					
Roof	4,491	6.5%	6,259	7.7%	39.4%
Basement	8,475	26.4%	9,617	27.4%	13.5%

TABLE 3

Extent of Housing Problems in the U.S. by Housing Tenure: 1975 and 1983 (Units in Thousands)

		Owners			Renters		
		1975	1983	Percent Change	1975	1983	Percent Change
Number of Households		46,920	54,890	+17.0%	25,633	29.952	+16.8%
Percent of Total Households		64.7%	64.7%	—	35.3%	35.3%	—
Inadequate Units	#	3,507	3,420	−2.5%	4,197	4,141	−1.3%
	%	7.5%	6.2%	—	16.4%	13.8%	—
Severely Inadequate Units:	#	1,203	1,178	−2.1%	1,920	1,698	−11.6%
	%	2.6%	2.2%	—	7.5%	5.7%	—
Crowded Units	#	1,585	1,034	−34.8%	1,157	1,196	+3.4%
	%	3.4%	1.9%	—	4.5%	4.0%	—
Cost Burdened Households:	#	2,552	4,581	+79.5%	6,200	9,844	+58.8%
	%	5.4%	8.4%	—	24.2%	32.9%	—
Total Units With Housing Problems:	#	7,644	9,035	+18.2%	11,554	15,181	+31.4%
	%	16.3%	16.5%	—	45.1%	50.7%	—

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

TABLE 4

Distribution of Housing Problems by Income Class: 1983

	All Households	Very Low Income Households[a]	Low- to Moderate-Income Households[b]	All Other
Occupied Housing Units/ Households	100.0%	27.0%	18.2%	54.8%
Renters	100.0%	43.0%	21.7%	35.3%
Inadequate Units	100.0%	50.3%	20.5%	29.2%
Severely Inadequate Units	100.0%	56.8%	18.1%	25.1%
Crowded Units	100.0%	41.5%	22.6%	35.9%
Cost Burdened Households	100.0%	71.9%	19.2%	8.9%
Units With Housing Problems	100.0%	62.4%	19.9%	17.7%

[a] A very low income household is defined as having an income 50 percent or less of the local area median family income.

[b] A low- to moderate-income household is defined as having an income 51 to 80 percent of the local area median income.

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

TABLE 5

Trend in Housing Problems Among Very Low Income Households: 1975 and 1983[a] (Units in Thousands)

		1975	1983	Percent Change
Number of Households		19,117	22,943	+20.0
Percent of All Households		26.3%	27.0%	—
Inadequate Units	#	3,918	3,805	−2.9
	%	20.5%	16.6%	—
Severely Inadequate Units:	#	1,876	1,633	−13.0
	%	9.8%	7.1%	—
Crowded Units:	#	856	926	+8.2
	%	4.5%	4.0%	—
Cost Burdened Households	#	7,049	10,368	+47.1
	%	36.9%	45.2%	—
Total Units With Housing Problems	#	11,823	15,099	+27.7
	%	61.9%	65.8%	—
Percent Which Rent		52.9%	56.1%	—

[a] A very low income household is defined as having an income 50 percent or less of the local area median income.

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, 1986.

housing units.[10] Overall, very low income households occupy about two-thirds of all units with housing problems. Low- to moderate-income households make up about 18 percent of all households and occupy about 20 percent of all units with housing problems.[11] Thus, that income group is experiencing housing problems roughly in accordance with its share of all households. Middle- and upper-income households represent about 55 percent of all households yet occupy under 18 percent of units with housing problems.

Table 5 presents the trends in housing problems among very low income households during the period from 1975 to 1983. During that period the number of very low income households increased by 20 percent, a bit faster than the 17 percent growth for all households. The incidence of physically inadequate units was relatively high—16.6 percent in 1983 compared to 8.9 percent for all households—but in absolute terms declined at a faster rate during the 1975 to 1983 period than for all households—minus 2.9 percent versus minus 1.8 percent. The number of very low income households living in crowded housing declined in relative terms but increased by 8.2 percent in absolute terms. The number of cost burdened very low income households increased sharply in both relative and absolute terms during the period. By 1983, 45 percent of very low income households were cost burdened. Overall, two out of every three very low income households experienced some type of housing problem.

> **The result has been that "Americans today are the best-housed people in history."**

Tables 6 and 7 present additional information on the characteristics of these very low income households. For example, half of all very low income households are female headed, about one-third are headed by an elderly individual, nearly 20 percent are black headed, while about 8 percent are hispanic headed. (Note that these groups are not mutually exclusive. For example, a female headed household may also be a black, hispanic or elderly headed household.) Alternatively, 49 percent of all female headed households have very low incomes, as do 44 percent of elderly headed households, 48 percent of black headed households and 41 percent of hispanic headed households. Each of these groups of very low income households is experiencing a high incidence of housing problems, particularly affordability problems. For example, 67 percent of very low income female headed households were experiencing housing problems in 1983, with 48 percent being cost burdened, 16 percent living in physically inadequate units and 3 percent living in crowded units. For black and hispanic headed households the incidence of housing problems is even greater. For both groups, nearly eight of every ten very low income households were experiencing some form of housing problem. To be expected, affordability is the most common housing problem, although the incidence of physical inadequacy is also relatively high.

TABLE 6

Extent of Housing Problems for Selected Groups of Very Low Income Households: 1983[a] (Units in Thousands)

		Female Headed Households	Elderly Headed Households	Black Headed Households	Hispanic Headed Households
Very Low Income Households		11,474	7,867	4,402	1,899
Percent of Total Households		13.5%	9.3%	5.2%	2.2%
Percent of Very Low Income Households		50.0%	34.3%	19.2%	8.3%
Percent of Group		49.0%	44.1%	48.0%	41.1%
Inadequate Units:	#	1,675	1,133	1,313	451
	%	16.4%	14.4%	29.8%	23.8%
Severely Inadequate Units	#	743	502	562	164
	%	6.5%	6.4%	12.8%	8.6%
Crowded Units:	#	306	15	237	267
	%	2.7%	0.2%	5.4%	14.1%
Cost Burdened Households:	#	5,551	2,649	1,875	775
	%	48.4%	33.7%	42.6%	40.8%
Total Units With Housing Problems	#	7,732	3,797	3,425	1,493
	%	67.2%	48.3%	77.8%	76.6%

[a] Groups are not mutually exclusive. For example, a female-headed household may also be a black, hispanic or elderly-headed household.

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, 1986.

TABLE 7

Distribution of Housing Problems Among Selected Groups of Very Low Income Households: 1983[a]

	Female Headed Households	Elderly Headed Households	Black Headed Households	Hispanic Headed Households
Percent of Total Households	13.5%	9.3%	5.2%	2.2%
Percent of Inadequate Units	24.8%	15.0%	17.4%	6.0%
Percent of Severely Inadequate Units	25.8%	17.5%	19.5%	5.7%
Percent of Crowded Units	13.7%	6.7%	10.6%	12.0%
Percent of Cost Burdened Households	38.5%	18.4%	13.0%	5.4%
Percent of Units With Housing Problems	31.9%	15.7%	14.1%	6.2%

[a] Groups are not mutually exclusive. For example, a female-headed household may also be a black, hispanic or elderly-headed household.

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, 1986.

TABLE 8

Incidence of Cost Burden Among Income Groups: 1975 and 1983

	1975	1983
All Households	12.1%	17.0%
Very Low Income	36.9%	45.2%
Low- to Moderate-Income	10.2%	17.9%
All Other (Middle and Upper Income)	0.8%	2.8%

Source of Data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

Elderly headed households with very low income had a relatively lower incidence of housing problems than the other groups. About one-third of very low income elderly headed households were cost burdened while about 14 percent lived in physically inadequate units. The incidence of crowding is extremely low for this group. One factor in this relatively favorable housing situation for the very low income elderly is that the homeownership rate among this group is around 60 percent, significantly higher than for the other groups. Thus, earlier in their lives when they likely had higher incomes, large numbers of the elderly became homeowners, which helped to stabilize their housing costs. Later in their lives incomes typically fell, increasing the burden of housing costs and leading to some deterioration in the physical quality of the unit. However, despite their current very low income status the housing situation of the elderly is favorable relative to these other groups for which homeownership rates are much lower.

While the incidence of cost burden among very low income households grew sharply in both relative and absolute terms, the increase in cases of cost burden was not confined to this income group. As shown in Table 8, cost burden worked its way up the income scale during the 1975 to 1983 period. The incidence of cost burden increased from 10.2 percent of lower-to-moderate income households to 17.9 percent. Similarly, the incidence of cost burden increased among middle- and upper-income households as well.

The relationship between housing tenure and the extent of housing problems

The data in this HUD study reveal several additional interesting developments during the 1975 to 1983 period. First, while the aggregate homeownership rate in 1983 was the same as in 1975, the homeownership rate for very low income households declined. As shown in Table 9, the homeownership rates for both very low and low-to-moderate income households were lower in 1983 than in 1975 while the homeownership rate for other households, those with middle and upper incomes, was higher. This is the result of several factors, as shown in Table 10. First, most of the growth in very low income households during this period was among groups that had homeownership rates below the average for all very low income households, such as female headed households. Further, the homeownership rates within most of these specific groups of very low income households declined as ownership affordability declined from 1975 to 1983.

A second interesting trend is that even among very low income households, there is a higher incidence of housing problems among renters than among owners. As shown in Table 11, within the very low income group, owners make up 43.9 percent of total households but represent just 32.2 percent of the households experiencing a housing problem. Within selected groups of very low income households, such as female-headed, elderly-headed, etc., this same relationship exists—owners experience a smaller proportion of all types of housing problems than their proportion of total households in that group. Thus, homeownership is associated with a lower incidence of all forms of housing problems for households at all income levels.[12]

TABLE 9

Homeownership Rates by Income Class: 1975 and 1983

	All Households	Very Low Income	Low- to Moderate-Income	Other (Middle- and Upper-Income)
1975	64.7%	47.1%	58.5%	75.2%
1983	64.7%	43.9%	57.9%	77.2%

Source of Data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

TABLE 10

Change in Very Low Income Households by Selected Groups: 1975 to 1983[a]

	Total	Female Headed Households	Elderly Headed Households	Black Headed Households	Hispanic Headed Households
Homeownership Rate: 1975	47.1%	41.8%	61.1%	31.7%	28.2%
Homeownership Rate: 1983	43.9%	39.3%	60.4%	32.2%	22.2%
Percent Change in Number of Households:					
1975 to 1983	20.0%	22.6%	3.5%	22.1%	61.1%
Percent of Change in Number of Very Low Income Households	100.0%	55.3%	6.9%	20.8%	18.8%

[a] Groups are not mutually exclusive. For example, a female-headed household may also be a black, hispanic or elderly-headed household.

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

TABLE 11

Distribution of Housing Problems Among Very Low Income Households by Housing Tenure: 1983

	Total	Owner	Renter
All Very Low Income Households	100.0%	43.9%	56.1%
Inadequate Units	100.0%	37.1%	62.9%
Severely Inadequate Units	100.0%	34.2%	65.8%
Crowded Units	100.0%	25.3%	74.7%
Cost Burdened Households	100.0%	31.0%	69.0%
Total Housing Problems	100.0%	32.2%	67.8%

Source of data: Irby, Iredia. "Attaining the Housing Goals?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

The data presented illuminate several important facts regarding the housing situation in the United States. First, while the physical condition of the housing stock has vastly improved since the end of World War II, millions of primarily lower-income households continue to live in housing plagued by serious physical defects. Second, for an even larger and growing number of households, acquiring physically adequate and uncrowded shelter represents a financial burden. Moreover, while the affordability problem is largely concentrated among lower-income households, it is increasingly becoming a problem for middle-income families as well. Clearly, for numerous reasons housing costs are rising faster than income for an expanding segment of our society. ☐

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[1] The Report of the President's Commission on Housing, Washington, D.C., 1982, p. xviii.

[2] Source: 1983 Annual Housing Survey (AHS).

[3] The Report of the President's Commission on Housing, Washington, D.C., 1982, p. xvii.

[4] Irby, Iredia. "Attaining the Housing Goal?" U.S. Department of Housing and Urban Development, housing and demographic analysis division, office of economic affairs, July 1986.

[5] 1983 is the most recent year for which data are available. A new survey, the *American Housing Survey*, was conducted in 1985. Results from that survey should be available by late summer or early fall of 1987.

[6] The AHS gathered 35 indicators of housing condition and quality. These indicators are used to precisely define the conditions of inadequacy and severe inadequacy. Other researchers have used these same indicators to derive somewhat different definitions of physical inadequacy.

[7] The terms household and occupied housing unit are used interchangeably due to the fact that a household is defined as a person or group of persons who occupy a housing unit.

[8] The major categories of housing problems are mutually exclusive. Crowded units are only those which are physically adequate while cost burdened households are only those in physically adequate, uncrowded units. In 1983, 2.9 million households living in physically inadequate and/or crowded units were also cost burdened, bringing the total number of cost burdened households to 17.3 million or 20.4 percent of all households.

[9] Analysis suggests that many of these maintenance deficiencies are temporary. See National Association of Home Builders, *Low- & Moderate-Income Housing: Progress, Problems and Prospects*, 1986, pp. 8-9.

[10] A very low income household is defined as having an income 50 percent or less of the local area median family income. Cash income only is used in making this classification.

[11] A low- to moderate-income household is defined as having 51 to 80 percent of the local area median family income. Cash income only is used in making this classification.

[12] It should be noted that households surveyed in the AHS are asked to self-evaluate their housing situation. Therefore, it is possible that there is some bias in the responses. It seems likely that owners would be less critical of their housing situation than would renters given the fact that they have a significant investment in the property. However, the difference in incidence of housing problems between owners and renters when income and household characteristics are controlled for is large enough to suggest that a significant relationship may exist.

MORTGAGE MARKET TRENDS

Preliminary data indicate that real gross national product (GNP) increased at an annual rate of 2.6 percent during the second quarter, down from a revised 4.4 percent during the first quarter. This second quarter slowing in real GNP growth was due primarily to a slowing of the pace of inventory accumulation. In real terms, inventories rose by $41 billion (annual rate) compared to $48 billion during the first quarter, subtracting 0.7 percentage points from the second quarter growth rate.

Final sales—GNP less inventory investment—increased at a healthy pace during the second quarter. Consumer spending in real terms rose about 2 percent at an annual rate due largely to a recovery of auto sales. Business investment in equipment increased nearly 12 percent after having declined sharply during the first quarter. Real net exports—the balance between exports and imports–increased for the third successive quarter.

Growth of the economy during the current quarter will likely be comparable to that of the second quarter. Consumer spending should increase moderately while business fixed investment also increases but less than in the second quarter. However, residential investment should continue to decline, reflecting a further decline in apartment construction and the effects of the rise in mortgage interest rates since March on the single-family market. Auto production is also likely to decline in the third quarter, contributing to another reduction in inventory investment.

However, there is mounting evidence that, aside from autos, the manufacturing sector is experiencing robust growth due largely to its improved competitive position in international markets. In July, manufacturing employment increased by 70,000, despite the fact that employment in the auto industry fell by 38,000. Industrial production rose a strong 0.8 percent in July with the largest increases occurring in business equipment, intermediate materials and mining. These increases in employment and production likely stem from a substantial increase in unfilled orders for durable goods in recent months. From March to June, unfilled orders for all durable goods increased at an annual rate of 15 percent; for non-defense capital goods, the annual rate of increase was 19 percent. These large increases in unfilled orders are probably due to the combined effect of increasing exports and the substitution of domestically produced goods for imported goods. During the past three quarters, the volume of non-farm exports has risen at an annual rate of 13 percent while non-oil imports have increased at a mere 1 percent. Given this significant turnaround in the trade balance, MBA expects growth of GNP to accelerate to 3 percent or somewhat higher later this year and through 1988.

Recent price statistics suggest that inflation will be more moderate during the second half of this year than during the first half. Both producer prices for finished goods and consumer prices rose substantially less in May and June than during the first four months of the year. The contribution of energy prices to overall inflation is diminishing and wages continue to rise at a moderate pace. Thus, consumer prices should increase at an annual rate of about 4 percent during the second half compared to nearly 5½ percent during the first half.

However, the economy is well into its fifth year of expansion with the unemployment rate down to 6 percent. Therefore, it is highly likely that the expected acceleration of economic growth will be associated with both rising inflation and rising interest rates. In 1988, the rate of inflation in consumer prices should rise to about 5 percent as the rate of increase of wages and salaries begins to pick up. Interest rates should rise in response to the more rapid growth of the economy and the strong likelihood that the Federal Reserve will tighten monetary policy later this year or in early 1988 to ensure that the economy does not overheat. Mortgage interest rates should rise about 11 percent by the second half of 1988. The rise in interest rates will act to curb moderately the level of activity in credit sensitive sectors such as housing.

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Senior Economist
August 14, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1987												
JAN	105	75	30	1,816	1,332	484	102	69	33	1,652	1,181	471
FEB	103	76	27	1,838	1,379	459	101	76	25	1,676	1,313	363
MAR	141	107	34	1,730	1,296	434	150	109	41	1,719	1,244	475
APR	159	124	35	1,643	1,275	368	157	117	40	1,598	1,152	446
MAY	158	119	39	1,602	1,185	417	136	104	32	1,493	1,100	393
JUN$_p$	165	123	42	1,590	1,174	416	156	119	37	1,514	1,122	392
1986 TOTAL	1,806	1,263	543				1,769	1,185	584			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
6 MONTHS												
1987	831	625	206				806	597	209			
1986	932	646	286				908	607	301			
1985	855	582	273				843	540	303			
1984	914	631	283				899	578	321			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
YEAR AND MONTH	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1987																
JAN	16	16	44	29	336	431	589	460	14	14	41	29	286	362	568	436
FEB	10	14	45	34	291	371	675	501	15	16	43	27	319	388	577	392
MAR	22	24	57	40	296	348	616	470	25	26	60	41	317	335	624	443
APR	26	28	66	40	272	305	665	401	27	32	58	41	290	305	588	415
MAY	28	33	60	37	295	311	619	377	26	28	50	33	274	284	575	360
JUN$_p$	29	36	57	43	267	290	606	427	30	29	58	39	285	264	599	366
1986 TOTAL	294	296	733	484					283	290	687	510				
1985 TOTAL	252	240	782	468					260	237	753	484				
6 MONTHS																
1987	130	150	328	223					139	144	311	213				
1986	134	138	405	255					132	137	379	261				
1985	110	109	400	236					122	105	378	238				
1984	86	115	478	236					92	103	451	253				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1987														
JAN	216	53	358	6.2	222.4	107.9	29.4	85.1	1,089	658	431	137	91	46
FEB	241	59	358	6.1	224.5	108.5	28.4	87.6	1,096	669	427	118	78	40
MAR	325	73	352	6.0	225.9	112.0	27.5	86.4	1,085	669	416	127	86	41
APR	331	72	355	5.9	224.7	112.8	27.0	84.9	1,070	675	395	135	94	41
MAY	346	61	353	6.8	227.9	112.7	26.7	88.5	1,063	670	393	130	93	37
JUN$_p$	361	60	361	6.7	223.1	113.5	25.3	84.3	1,067	674	393	146	107	39
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
6 MONTHS														
1987	1,820	378										793	549	244
1986	1,713	425										796	538	258
1985	1,522	360										788	531	257
1984	1,337	329										767	521	246

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
OCT	$56,285	$12,659	$20,760	$19,781	$3,085	$41,901	$11,535	$16,992	$12,985	$389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
DEC	74,941	14,615	26,639	27,478	6,209	47,459	13,148	19,298	14,720	293
1987										
JAN	42,804	9,748	12,888	18,641	1,527	31,421	8,791	10,477	11,932	221
FEB	44,756	10,518	13,128	19,103	2,007	31,486	10,012	10,773	10,534	167
MAR$_p$	55,498	14,311	17,994	20,960	2,233	40,433	13,876	15,061	11,357	139
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
3 MONTHS										
1987	143,093	34,577	44,045	58,704	5,767	103,340	32,679	36,311	33,823	527
1986	89,478	20,413	34,180	29,159	5,726	61,093	18,628	26,398	15,493	574
1985	66,722	12,621	26,703	23,026	4,372	42,999	11,594	19,227	11,985	193
1984	65,427	13,947	25,697	22,966	2,817	44,430	13,038	18,977	12,240	175

LENDER ACTIVITY (Cont'd.)
LONG-TERM LOANS CLOSED (Cont'd.)
(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
OCT	$3,560	$735	$1,933	$735	$157	$10,824	$389	$1,835	$6,061	$2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
DEC	6,753	919	3,629	1,677	528	20,729	548	3,712	11,081	5,388
1987										
JAN	2,878	529	1,340	877	132	8,545	428	1,111	5,832	1,174
FEB	2,659	222	1,144	1,053	240	10,606	284	1,206	7,516	1,600
MAR$_p$	2,751	71	1,421	1,004	255	12,314	364	1,512	8,599	1,839
3 MONTHS										
1987	8,289	822	3,905	2,935	627	31,464	1,076	3,829	21,946	4,613
1986	6,598	709	3,595	1,678	616	21,603	892	4,187	11,988	4,536
1985	5,079	584	2,776	1,307	412	18,644	443	4,700	9,734	3,767
1984	4,798	172	2,729	1,609	288	16,199	737	3,991	9,117	2,354

LONG-TERM COMMITMENT ACTIVITY
By Type of Institution
(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
OCT	$43,470	$8,959	$19,202	$12,593	$2,716	$138,510	$17,784	$49,878	$51,605	$19,243
NOV	35,692	8,263	17,111	7,554	2,764	129,903	20,974	48,994	40,726	19,209
DEC	43,851	13,033	19,548	7,979	3,291	124,310	23,189	43,014	41,809	16,298
1987										
JAN	29,161	7,044	13,718	6,674	1,725	116,876	18,703	40,419	41,594	16,160
FEB	34,440	10,941	11,585	9,599	2,315	137,570	20,664	49,401	51,121	16,384
MAR$_p$	48,848	12,078	23,671	9,974	3,125	135,835	20,110	52,366	47,241	16,118
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
3 MONTHS										
1987	112,496	30,063	48,974	26,294	7,165					
1986	102,354	30,315	44,607	17,896	9,536					
1985	60,261	9,966	33,988	8,946	7,361					
1984	61,573	12,569	32,604	10,884	5,516					

MORTGAGE INSURANCE
(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1987												
JAN	208	120	41	47	175	$12,143	95	$5,864	38	$2,718	42	$3,561
FEB	243	153	42	48	167	11,525	90	5,458	44	3,255	33	2,812
MAR	307	190	49	68	247	16,893	148	9,134	60	4,420	39	3,339
APR	285	165	41	79	227	15,768	142	8,947	41	3,021	44	3,800
MAY	216	104	38	74	230	15,838	149	9,265	36	2,622	45	3,951
JUN$_p$	212	93	43	76	219	15,501	120	7,502	47	3,424	52	4,575
1986 TOTAL	3,283	1,908	452	923	1,852	127,759	921	56,901	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,333	87,485	410	23,964	192	13,046	731	50,475
6 MONTHS												
1987	1,471	825	254	392	1,265	87,669	744	46,170	266	19,460	255	22,039
1986	1,759	1,133	201	425	761	51,826	376	23,073	135	9,606	250	19,147
1985	1,017	396	103	518	613	39,502	183	10,574	79	5,189	351	23,739
1984	994	243	113	638	753	47,733	166	8,935	116	7,448	471	31,350

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1987										
JAN	$948	$1,346	$101,687	$6,363	$7,455	$8,003	$7,950	$8,215	$13,932	$10,624
FEB	912	979	104,670	4,691	8,802	7,990	7,961	7,844	11,668	9,692
MAR	2,805	1,435	107,673	4,627	9,385	14,314	9,394	9,145	10,873	10,736
APR	3,208	2,118	112,673	6,997	8,167	12,965	9,777	9,852	15,050	11,934
MAY	1,726	1,718	116,861	7,086	n.a.	n.a.	n.a.	n.a.	10,220	3,515
JUN_p	1,745	1,690	121,270	6,648	n.a.	n.a.	n.a.	n.a.	14,077	4,950
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
6 MONTHS										
1987	11,344	9,286	—	36,412	33,809	43,272	35,082	35,056	75,821	51,451
1986	16,171	10,366	—	23,359	25,842	38,484	19,827	19,061	58,600	36,313
1985	10,418	10,880	—	8,200	14,644	15,480	10,877	9,498	24,139	17,887
1984	10,118	9,185	—	5,416	6,025	6,430	5,081	3,907	19,004	15,263

*Year-to-date totals are for four months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA New[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1987								
FEB	8.81%	9.04%	9.04%	9.23%	9.21%	8.48%	8.668%	10.25%
MAR	8.94	9.19	9.20	9.14	9.09	8.06	8.633	10.24
APR	10.02	10.11	10.14	9.21	9.09	8.35	9.655	12.08
MAY	10.61	10.44	10.46	9.37	9.27	8.85	10.208	12.65
JUN	10.33	10.29	10.29	9.45	9.38	8.69	9.995	n.a.
JUL_p	n.a.	n.a.	n.a.	9.44	9.43	8.45	9.773	n.a.

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1987							
FEB	8.06%	8.21%	8.17%	8.82%	7.25%	5.59%	6.05%
MAR	8.12	8.25	8.22	8.84	7.25	5.60	6.16
APR	9.06	9.13	9.08	9.51	8.02	5.90	6.45
MAY	9.35	9.62	9.59	10.05	8.61	6.05	6.93
JUN	9.69	9.70	9.65	10.05	8.40	5.99	6.92
JUL	9.62	9.64	9.59	10.17	8.45	5.86	6.65

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1987				
FEB	−1	81	96	92
MAR	10	87	100	97
APR	51	104	111	106
MAY	56	74	101	98
JUN	16	129	130	125
JUL	n.a	117	119	114

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

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MORTGAGE BANKING

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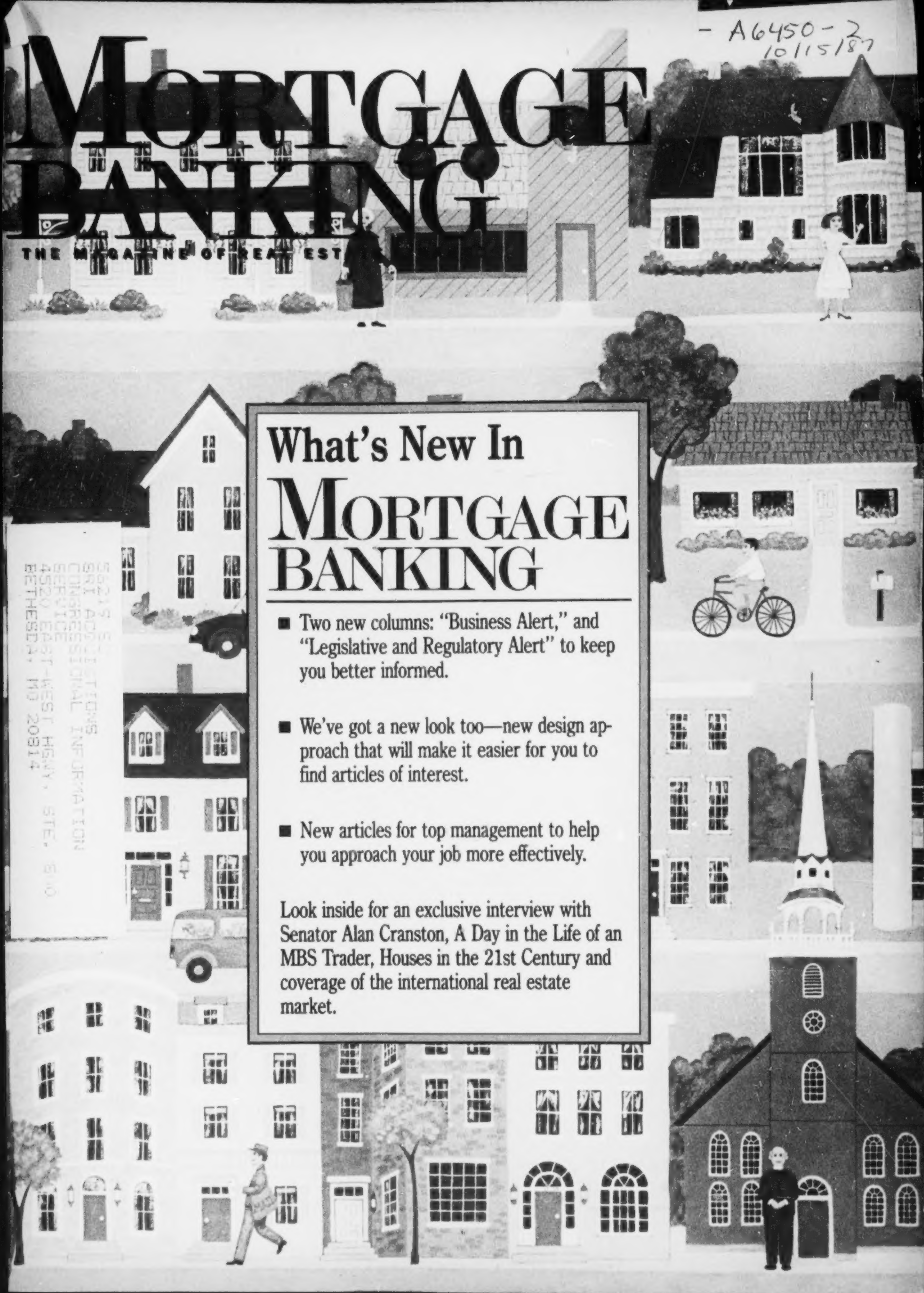

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MORTGAGE BANKING

- Two new columns: "Business Alert," and "Legislative and Regulatory Alert" to keep you better informed.
- We've got a new look too—new design approach that will make it easier for you to find articles of interest.
- New articles for top management to help you approach your job more effectively.

Look inside for an exclusive interview with Senator Alan Cranston, A Day in the Life of an MBS Trader, Houses in the 21st Century and coverage of the international real estate market.

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Published monthly since 1939
by the Mortgage Bankers
Association of America

Business and Editorial Offices
1125 15th Street, N.W.
Washington, D.C. 20005
Editorial (202) 861-6560
Advertising (202) 861-6555
Circulation (202) 861-6992

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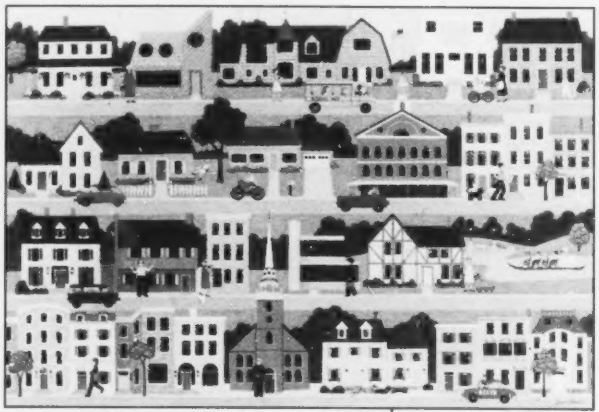
Subscription rates: $33 per year. $80 for three years or $20 each for ten or more subscriptions mailed to the same addressee. In Canada, $40 per year, foreign $40 per year. Individual copies, $2.75 each.

Second class postage paid at Washington, D.C. and additional mailing offices. Subscription orders should be sent to P.O. Box 37236, Washington, D.C. 20013. Letters, manuscripts, change of address and all other correspondence should be sent to *Mortgage Banking*, 1125 15th Street N.W. Washington, D.C. 20005. Six to eight weeks are required for a change of address. Along with a new address, send last magazine label.

EDITORIAL PAGE



THE ISSUE

Dear Reader:

Recognizing the need for change and harnessing its potential can mean the difference between success and failure in today's fast-paced financial environment. MORTGAGE BANKING has recognized the need for change and with this issue offers you a new look, is broader in scope, but, as always, contains solid articles that help you do your job better.

We believe this issue will help you harness change to your benefit with the addition of two new columns that summarize legislative and regulatory initiatives critical to shaping your spreadsheet and affecting your bottom line. We also are introducing a new series of monthly interviews with national leaders whose perspectives on compelling issues and financial matters we think you will find of interest. This month we talked to Senator Alan Cranston (D-CA), the driving force behind a renewed National Housing Policy.

In addition, we are introducing the beginning of what will be a continuing series of articles aimed at top management. This issue Felix Beck, Chairman of Margaretten & Company and a past MBA president, talks about leadership.

We are expanding the scope of MORTGAGE BANKING in another way, too. We will offer more articles about housing and finance that cover a broader range of topics. Be sure to read "Houses of the 21st Century" and "A Day in the Life of an MBS Trader." And don't miss two other articles that will help you to do your job better: "Prepayment Projections" and "How to Design a Human Resource Hierarchy."

We continue on the cutting edge of change with part two of our series on MBS residuals, as well as with three articles that follow the controversy of the loan commitment crisis. The latter detail new consumer laws and efforts by state lobbyists to deal effectively with legislators. One tells you how to make money; the others, how to cut your losses.

More Than A Pretty Face

MORTGAGE BANKING's changes are not all in the printed word, however. We offer a new look as well. We have always been a showcase for creative art and design, but with this issue we have improved the aesthetics of the magazine in a way that makes it easier for you to find the articles you want.

So, as you peruse one of our regular features, such as "People" or "Secondary Mortgage Markets" or delve into one of our new additions, such as "Mortgage Products for all Palates," I bid you good reading.

Jane DeMarines
Senior Director of Public Affairs and Publications

THE COVER

Since 1630, Boston has evolved into an international center for American finance, trade, culture, education, medicine and architecture. Where else could one find the homes of such historic figures as Paul Revere standing only a few short blocks from the glassed-walled towers that house some of the country's financial and industrial giants?

Mortgage bankers exhibit the same flexibility and resourcefulness that has enabled Boston to retain the best of the old while becoming a modern metropolis. It is particularly fitting, then, that MBA's convention will be held this year in a dynamic environment that embodies the diversity of those whom the association serves.

Margaret Yao
Editor

THE ARTIST

This month's cover of the architecture in Boston was painted by Joan Landis, a freelance artist who specializes in primitive style painting. Included among her favorite subjects to paint are family history series. Her works have appeared in *Saturday Evening Post, Redbook, Seventeen, Mother Earth* and *Ladies Home Journal.* She works with numerous corporations painting for their advertisements. Her medium is acrylic and she works out of a studio in New York City.

AND NEXT ISSUE

Multifamily Housing and the Role of the Federal Government

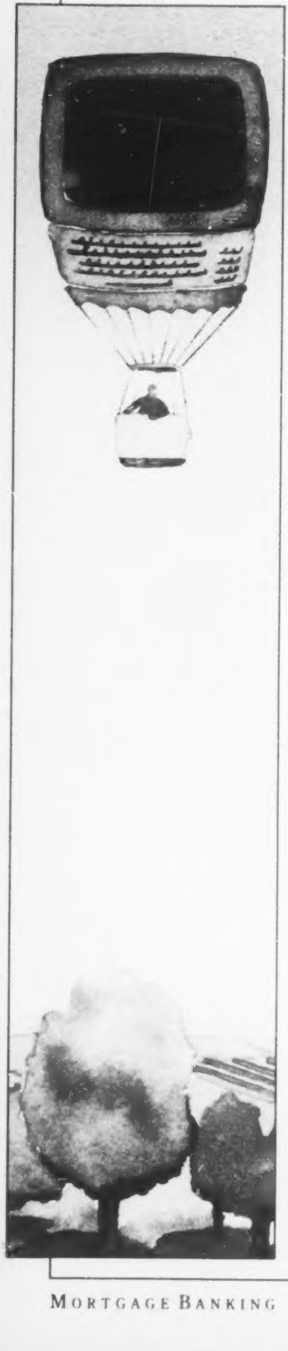
Low-Income Housing: an Element in the National Housing Policy

Control over Loan Servicing

An Update on the Non-Conforming Market

CONTENTS

OCTOBER 1987 VOLUME 48 NUMBER 1



Legislative **16** **The Role of the Federal Government in Real Estate Finance: Standardize and Stabilize**
In an exclusive inteview with Mortgage Banking, *Senator Alan Cranston, (D-CA) discusses his views on the current housing situation.*

Residential **27** **National Housing Policy: America's Commitment to Decent Housing?** *by* THOMAS M. FRENCH, JR.
MBA President Thomas M. French, Jr. addresses the many issues surrounding a national housing policy.

Secondary Market **36** **A Day In the Life of an MBS Trader** *by* MIKE STAMPER
Explore a day in the life of a Freddie Mac trader. Discover the intracacies of the security sales and trading group at Freddie Mac.

Secondary Market **47** **Sculpting the Fannie Mae MBS** *by* ROB LEVIN
The mortgage-backed security has developed into an important real estate finance tool. Just how important is it and what role will it play in the future?

Residential **55** **Prepayment Projections** *by* DR. JOSEPH C. HU
Prepayments are occurring more frequently for most mortgage lenders. Learn how to use a less complicated method to project prepayments.

Management **62** **What Makes a Leader?** *by* FELIX BECK, CMB
Some people are born to lead, but for most successful executives, they are taught to lead. Consider these tips and become more than just a manager.

Marketing **74** **Market Segmentation: The Quantum Leap to Success** *by* ELLEN SCHLOEMER AND RUSS JENKINS
Marketing magic is more than just what meets the eye. Careful demographic analysis and targeting are prerequisites if you are to create the right marketing mix.

Residential **84** **Housing: In the 21st Century** *by* JAMES M. FISCHER, JR.
What will housing look like in the future? The president of the National Association of Homebuilders provides an enlightening look.

continued

Residential 94 **Mortgage Products for all Palates**
Lenders today are required to balance the mix between what homebuyers want and what investors demand. A cross section of experts from across the country explain how they are accomplishing this delicate task.

Secondary Market 107 **What's New with REMICs and CMOs: The Developing Market for Residuals—Part 2**
Part two of a continuing series details the developing residual market.

Internal Management 126 **BUSINESS BASICS**
Mortgage Banking Operations: How to Design a Human Resource Hierarchy *by* JOHN HEAMON
Most mortgage banking operations should consider the functional approach to designing an organizational plan.

International 138 **Foreign Infiltration: The Globalization of Real Estate** *by* JOHN TSUI
The Japanese have gone beyond the electronics and auto industries. Japanese investors are flocking to U.S. real estate as a profitable and lucrative investment.

International 139 **The World Market for Floating Rate CMOs** *by* PAT SHERLOCK
Mortgage-backed securities are a hot item with foreign investors. Learn why this investment product is becoming part of the international finance scene.

Automation 154 **CLO Update: Bringing Consumer, Realtor and Lender a Step Closer?** *by* KIM ANDERSON
CLOs are giving the small lender a tremendous boost in the race against the financial giants.

Legislative 166 **Mortgage and Real Estate Law: Traps for the Unwary, Recent Legal Developments in Mortgage Banking** *by* ANDREA LEE NEGRONI
A plethora of new laws and regulations make it mandatory for all mortgage bankers to be aware of recent and upcoming proposals that affect the industry.

Regulatory 167 **Mortgage and Real Estate Law: Caveat Emptor, Caveat Faenerator** *by* LAURENCE PLATT
Borrowers are seeking to redress grievances against lenders in droves. Each state varies in its consumer protection statutes. Lenders should be aware.

State and Local 190 **Weathering the Wave of Legislative Change** *by* MIKE ROSSER
One important strategy in dealing with the new wave of legislation is becoming politically active.

Departments

3 EDITORIAL PAGE
11 BUSINESS ALERT
13 LEGISLATIVE AND REGULATORY ALERT
126 BUSINESS BASICS
198 PEOPLE
203 SECONDARY MORTGAGE MARKET
205 MORTGAGE MARKET TRENDS
214 AD INDEX

PREPAYMENT PROJECTIONS

Prepayments occur because of home sales or refinancing. Using the turnover rate of single-family housing stock is a less complicated method to project prepayments.

Dr. Joseph C. Hu

Current prepayment rate projections for mortgage pass-throughs are generally derived from econometric models that incorporate option theory. Explanatory variables of the models often include weighted average age and the interest rate on the underlying mortgages, current market mortgage rates, housing prices, equity build-up in homes, and other housing and demographic factors. Conceptually, these quantitative models can produce a wide range of projections under various interest rate scenarios for numerous coupons and sectors (Ginnie Maes, Fannie Maes and Freddie Macs). These projections, however, are dependent entirely on assumptions about the future behavior of the explanatory variables. More important, these projections assume that the same institutional and housing finance environment that existed during the period studied will prevail in the future.

A less complicated method for projecting prepayment is to identify and forecast the turnover rate of the single-family housing stock. Prepayments typically occur for two reasons: home sales or refinancing. For seasoned mortgage pass-throughs with coupon rates of 10 percent and below (low coupon pass-throughs), housing activity almost dictates prepayments. There is a strong relationship between generic prepayments for low coupon pass-throughs and the turnover rate of the single-family housing stock. Extrapolating from this relationship, it is possible to project future prepayments based on a qualitative assessment of the outlook for housing activity. Because housing activity is expected to continue strong, prepayments for seasoned, low coupon pass-throughs are likely to remain near historically high levels in 1987.

ILLUSTRATION BY MICHAEL GIBBS

The turnover rate for the single-family housing stock is defined as the ratio of sales of existing homes to the stock of single-family housing that is available for transaction (transaction housing stock). For example, 1983 sales of existing homes, as reported by the National Association of Realtors, were 2.7 million units (See Figure 1). The latest *Annual Hous-*

ing Survey, conducted jointly by the Commerce Department's Bureau of the Census and the Department of Housing and Urban Development, estimated the total single-family housing stock in 1983 at 61.4 million units. However, this number should be adjusted downward because there were only 43.5 million units of "specified, owner-occupied" single-family housing. As defined by the survey, these specified housing units are located on a lot of less than 10 acres with no business on the property. These units are most likely to be on the resale market and sold through Realtors. Nevertheless, the specified housing stock should be further adjusted downward because houses that have recently sold are less likely to be for sale again within a certain period. Thus, the transaction stock is computed by assuming that homeowners will normally stay in a new residence for at least two years before moving again. Consequently, subtracting the sales of existing homes during both the current and the previous year from the specified housing stock gives an estimate of 1983 transaction housing stock at 38.8 million units. The housing turnover rate for 1983, therefore, was 6.9 percent (see Figure 2).

While mortgage prepayments are primarily caused by home sales, they can also result from defaults and disaster (See Figure 2). If for any reason the mortgagor is unable to continue servicing the mortgage debt, the lender will eventually foreclose and sell the property, causing a prepayment. Statistics provided by the Federal Home Loan Bank Board indicate that annual default rates during the 1980s have increased steadily from 0.1 percent in 1980 to about 0.8 percent. In addition, a small fraction of the housing stock is constantly being destroyed, either by natural disaster or human events, causing more prepayments. The *Annual Housing Survey* reports that each year roughly 0.4 percent of the housing stock is permanently lost.

These projections assume that the same institutional and housing finance environment that existed during the period studied will prevail in the future.

FIGURE 1

Owner-Occupied Single-Family Housing Stock and Existing Home Sales, 1977–1987
(Millions of units)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987^p
Specified housing stock[1]	37.6	38.5	39.5	39.5	40.5	42.0	43.5	44.6	45.7	46.5	47.5
Adjustment factor[2]	6.5	7.7	7.8	6.8	5.4	4.4	4.7	5.6	6.1	6.7	7.3
Transaction housing stock[3]	31.1	30.8	31.7	32.7	35.1	37.6	38.8	39.0	39.6	39.8	40.2
Existing home sales	3.7	4.0	3.8	3.0	2.4	2.0	2.7	2.9	3.2	3.6	3.4

1 Single-family homes on less than 10 acres, without a business on the property, housing stocks for all years are estimated, except 1980 and 1983
2 Specified housing stock minus sales of existing homes for the current and the previous year
3 Specified housing stock minus adjustment factor
p: projection

Sources National Association of Realtors, Bureau of the Census, Deparment of Commerce, and Department of Housing and Urban Development, *Annual Housing Survey*

FIGURE 2

Comparison of Alternative Prepayment Projection with Constant Prepayment Rates for Seasoned Low Coupon Pass-Throughs,* 1977-1987 (Percent)

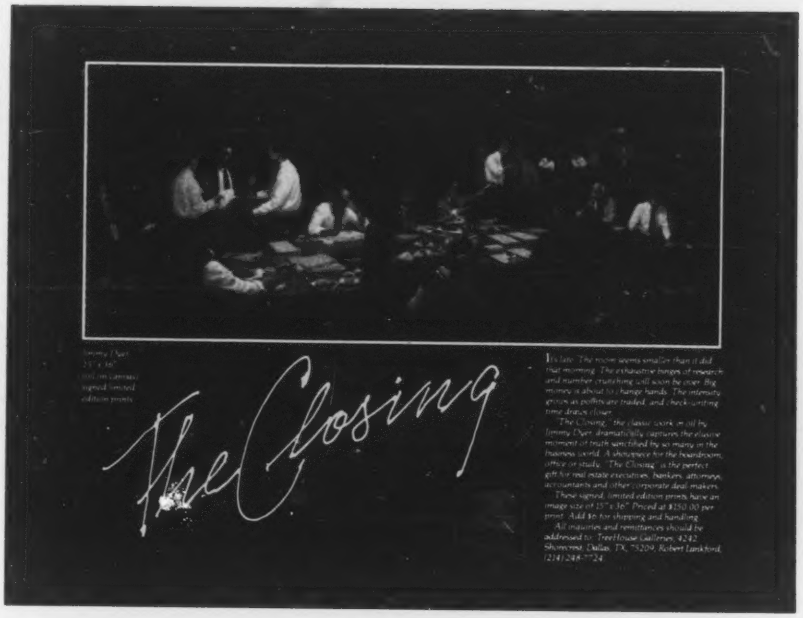
	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987^p
Alternative prepayment projection											
Housing turnover rate	12.0	13.0	12.0	9.2	6.8	5.3	6.9	7.4	8.0	9.0	8.5
Default rate	0.1	0.1	0.1	0.1	0.2	0.6	0.6	0.7	0.8	0.9	0.8
Disaster rate	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total	12.6	13.6	12.6	9.7	7.4	6.3	7.9	8.5	9.6	10.3	9.7
Constant prepayment rate											
FHLMCs	—	—	—	—	—	3.5	6.2	7.0	7.9	12.0	11.0
FNMAs	—	—	—	—	—	4.7	6.2	6.4	7.1	11.4	10.5
GNMAs	12.8	11.6	10.3	3.3	1.4	1.5	3.2	2.9	3.9	7.4	6.5

* Coupon rates 10% and below
p: projection

Sources: *Annual Housing Survey*, Shearson Lehman Mortgage Securities Group

For seasoned, low coupon pass-throughs, prepayment rates can be approximated by summing turnover, default and disaster rates. The total of these rates—the alternative prepayment projection—can be compared with prepayment rates of low coupon Freddie Macs, Fannie Maes and Ginnie Maes for the period 1977 to 1986 (See Figure 2). (Because both the Freddie Mac guarantor and Fannie Mae mortgage-backed security programs were implemented in 1981, prepayments for Freddie Macs and Fannie Maes were not available until 1982.) Between 1977 and 1979 when housing activity was extremely strong, the alternative projection modestly overestimated Ginnie Mae prepayment rates. This difference can be explained by the Ginnie Mae's underlying FHA/VA mortgages which historically have financed only 20 percent of home purchases. Borrowers of Federal Housing Administration/Veterans Administration (FHA/VA) loans in general have significantly lower incomes and, therefore, are less mobile than borrowers of conventional loans that have financed the other 80 per-

A less complicated method for projecting prepayment is to identify and forecast the turnover rate of the single-family housing stock.



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cent of home purchases. The prepayment rates on Ginnie Maes, therefore, were expectedly lower than the housing turnover rate.

During 1980 and 1983 the sum of housing factors overestimated prepayments by a wide margin. This discrepancy is probably due to the assumption of existing mortgages by homebuyers—a widespread practice in periods of high mortgage rates. During the early 1980s, historically high mortgage rates substantially slowed housing activity and reduced prepayments. Moreover, in that environment, there was strong incentive for sellers to provide financing to prospective buyers. One significant feature of this financing was the practice of sellers allowing buyers to assume the existing mortgage on the home. Consequently, a home sale was consummated without a mortgage prepayment further slowing prepayments. As mortgage rates dropped steadily after 1984, the reduced incentive of seller financing and more rigorous enforcement of due-on-sale enabled housing turnover rates to again closely approximate prepayments of seasoned, low rate mortgages.

For recent years, the alternative projection has improved as an estimator of prepayments. Between 1983 and 1985, the sum of the turnover, default and disaster rates was only moderately higher than prepayment rates. In particular, the housing turnover rate alone closely approximated prepayment rates for Freddie Macs and Fannie Maes although it still significantly overestimated prepayments for Ginnie Maes. However, using the rule of thumb that prepayments of Ginnie Maes are about one-half those of Freddie Macs and Fannie Maes, the housing turnover rate can still be a good indicator for Ginnie Mae prepayment rates. Incorporating the rule of thumb and considering that FHA/VA and conventional loans finance 20 percent and 80 percent of housing transactions, respectively, the 1986 alternative projection only slightly underestimated the prepayment rates for seasoned, low coupon pass-throughs. Finally, judging from the current levels of mortgage rates and housing affordability, housing activity is likely to be only slightly lower in 1987 than it was in 1986. Prepayments for low coupon pass-throughs, therefore, will remain close to historically high levels.

While future prepayment rates for seasoned pass-throughs will continue to be influenced heavily by housing activity, several institutional factors may cause their levels to edge up gradually. First, demographic demand for housing will remain strong—perhaps even stronger than in the past. The annual birth rate for the second half of the 20-year baby boom was 400,000 more than for the first half. These late baby boomers, now between 20 and 30 years old, have just begun to purchase their first homes. On the other hand, the early baby boomers have completed their first-time home buying and are ready to upgrade their housing. Housing finance permitting, the turnover of housing stock is likely to remain at high levels for the next five years or so. Also, the secondary mortgage market has expanded to include a broad base of investors and a wide variety of mortgage instruments. This expansion has greatly increased the funding sources for mortgages and reduced the fluctuation of housing activity due to changes in interest rates. Finally, the Tax Reform Act of 1986, which provides that only interest expenses from mortgages are deductible from taxable personal income, may increase prepayments caused by mortgage defaults. Because of the tax deductibility, homebuyers will want to borrow as much mortgage money as possible so that they can save cash for the purchase of other big ticket items. This incentive will raise the loan-to-value (LTV) ratio of new loans. Historically, high LTV ratios are closely associated with high defaults. ☐

Dr. Joseph C. Hu is executive vice president, director of mortgage research at Shearson Lehman Brothers in New York City.

Foreign Infiltration

The Globalization of Real Estate

In Japan, the savings rate is about 23 percent of disposable income compared to 5 percent for American households. Read why Japan and other countries with high savings rates are plowing their capital into U.S. real estate.

John F. Tsui

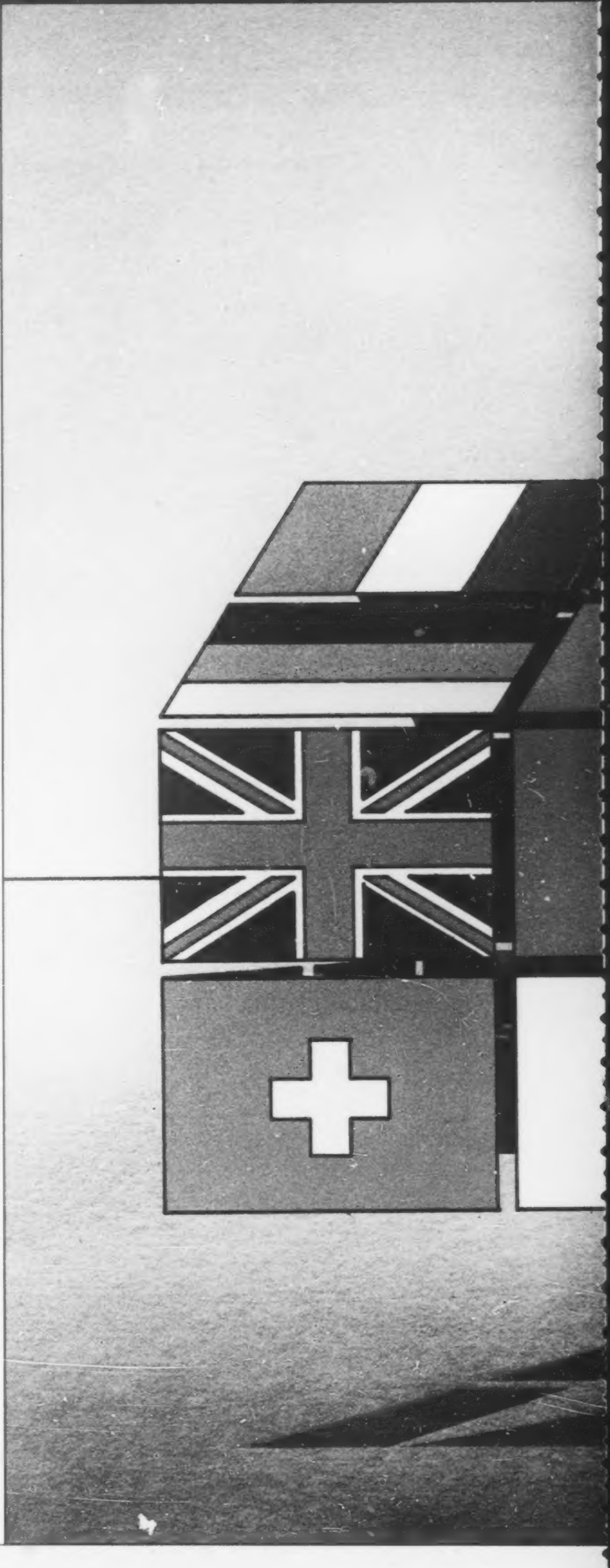
The invasion of U.S. real estate markets by foreign investors has captured major headlines and its growing presence will be more pronounced within the next five to seven years.

Between 1980 and 1986, foreign investment in U.S. real estate jumped 400 percent compared to a 30 percent average annual rate of growth occurring during 1978-1981. According to the Department of Commerce, England, Germany, Canada, Netherlands and Japan are the five most active participants in the U.S. property market. Japan has replaced Canada and England as the leading source of foreign investment.

Foreigners are not only snapping up signature-type office buildings in downtown locations, but are also acquiring U.S. corporate stocks, Treasury notes and agricultural land.

In downtown Los Angeles alone, foreign investors own more than two-thirds of all major office buildings. Approximately 30 percent of downtown's office inventory are owned by Japanese institutional or private groups.

Global *continued on page 141*



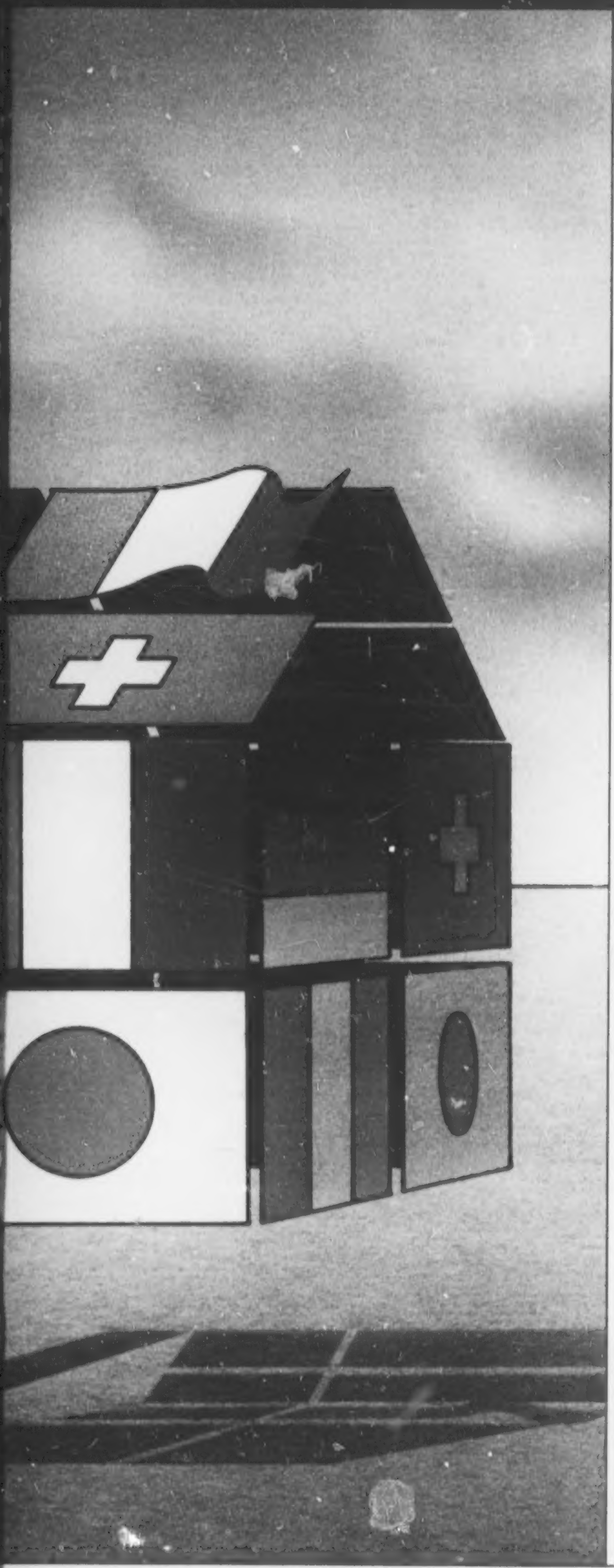


ILLUSTRATION BY STEPHEN BAUER

The World Market FOR Floating Rate CMOs

European and Japanese investors are buying American mortgage-backed securities and they are becoming an important investment product for the international sector.

Patricia M. Sherlock

Mortgage-backed securities have become an important investment product for the international sector. Similar to the rush of foreign buyers for domestic commercial real estate properties, U.S. agency mortgage-backed securities are being bought in the form of structured transactions by European and Japanese investors. The most popular instrument has been the floating rate collateralized mortgage obligations (FR CMOs).

Less than 12 months ago this was not the case. The Euromarket has historically been indifferent to mortgage-backed securities and the new derivative mortgage products. In September 1986, the Euromarket's position changed with the introduction of FR CMOs. The FR CMO product has revolutionized the CMO market. In 1987, more than 29 percent of the total CMO issuances have had floating rate classes (Table 1).

The general structure of CMOs

FR CMOs are a variation to the CMO structure. Every CMO bond class, regardless of the type of derivative feature, is basically a pay-through bond with different maturity classes supported by mortgage collateral. The mortgage collateral's cash flow is allocated in a priority sequence among the classes of bonds

Market *continued on page 147*

Global *continued from page 138*

The international expansion of financial services and the deregulation of the securities markets have pushed the domestic real estate industry into a wider global arena. This process has been further accelerated by telecommunications and computers.

What is also occurring in this globalization process is the integration of developed and developing national economies into a single global economy. Economic interdependence among nations is much more prevalent. America is no longer dependent upon what happens within the U.S. economy. Americans are now looking outward, especially across the Pacific, a shift away from our past inward orientation.

Another principal factor that favors foreign investment in the U.S. is the decrease of domestic competition from U.S. investors, especially the tax-driven syndicators.

Our current consumption and investment of more than we produce have resulted in substantial capital inflow into this country. Household savings rates in other developed countries are significantly higher than in the United States. In Japan, for example, the savings rate is about 23 percent of a person's disposable income, compared to 5 percent for American households. As a result, the high savings countries have been plowing their surplus capital into the United States and investing it into various financial and immovable assets.

The reasons behind the recent upward surge in foreign equity and debt capital into this country are:

- The U.S. is politically stable and the market is large and wealthy;
- There is the prospect of higher yields than can be expected in foreign countries, after accounting for currency exchange differentials;
- The decline in the U.S. dollar against other currencies has propelled many foreign investors to buy U.S. real estate;
- There is the lack of suitable and sufficient real estate investments in their homeland;
- Nominal interest rates in other industrialized nations are lower than those in the United States. Hence, leveraged yields on U.S. properties financed with foreign capital are higher than internal financing. Overseas investors are now able to pay premium prices for U.S. properties, or accept lower going-in yields, than U.S. investors.

Another principal factor that favors foreign investment in the U.S. is the decrease of domestic competition from U.S. investors, especially the tax-driven syndicators. The Tax Reform Act of 1986 has severely curtailed interests among syndicators to acquire properties for tax shelter purposes. In fact, a tax-oriented investor who acquired an office building prior to tax reform will experience a 30 percent drop in after-tax cash flow in 1987.

Real estate equity yields in the U.S. are notably higher than other nations. Unlike stocks and bonds, real estate hinges less on cyclical timing. Besides, foreigners prefer owning physical assets as opposed to financial assets because physical assets are harder to destroy in times of political upheaval or expropriation.

Properties in the U.S. are transferred much more often than in other countries. This creates a greater pool of properties from which to acquire and it also gives them greater property variety and location.

What does the future hold with respect to offshore investments in U.S. real estate? The impact is still relatively small in comparison with the enormous size of the U.S. property market. Their presence appears much greater than their actual purchases.

The premium prices that have been paid by Japanese buyers for center city properties have driven up assessed values and property taxes on surrounding properties. Some upward pressure on actual rents will likely occur offsetting the downward pressure exerted by overbuilding. Property yields will continue to drop to a point where it will no longer pay foreign investors to snap up office buildings or hotels at above-market prices. However, at this point and time, there is still a healthy yield spread to continue to practice global yield arbitrage.

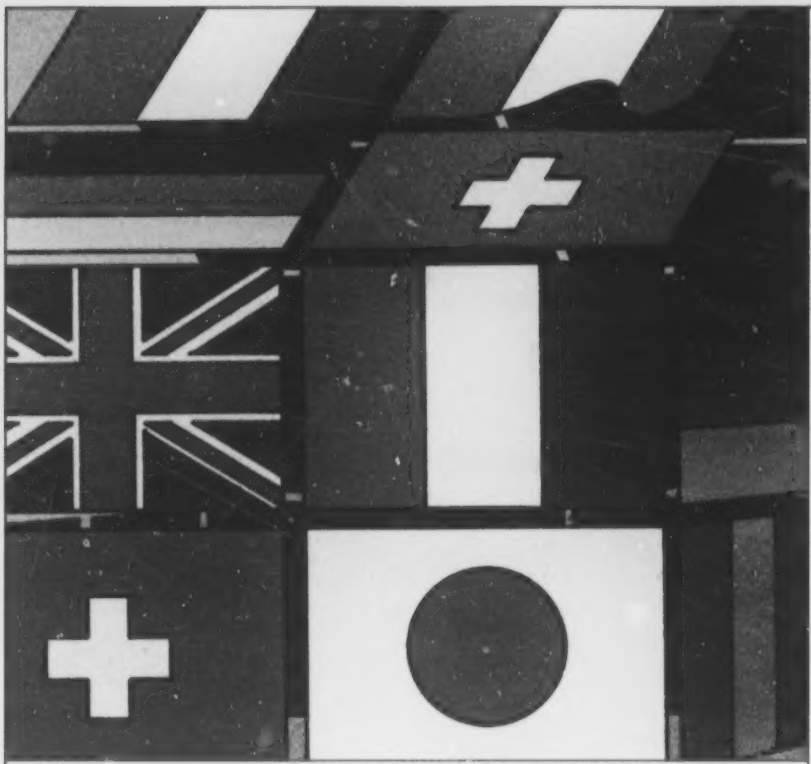
The revolution in property finance is also leading to new international dimensions. Domestic real estate lending is becoming more dependent on international financial conditions. Increasingly mega-real estate properties are being directly financed in foreign currency markets.

Foreign capital sources will undoubtedly play a more important and dominant role in the real estate finance industry. Japanese banks alone have made major inroads with respect to financing real estate projects. Some of the active participants include Long Term Credit Bank of Japan, Daiwa Bank, Sanwa Bank, Mitsubishi Bank, Bank of Tokyo Trust, Dai-Ichi Kangyo and Mitsui Bank. Other foreign banks that are active in real estate lending include Banque Indosuez, Banque Paribas, Bank of Montreal, Toronto Dominion, Deutsch Bank, Hong Kong Bank, Bank of East Asia, Barclays Bank, Marine Midland, and Credit Suisse.

Competitive pressure from large foreign banks to acquire U.S. banks and savings institutions will prevail as the process of merger and consolidation heightens. Foreign banks have acquired direct control of a number of small to medium-sized financial institutions. In fact, some of California's mid-sized banks are now owned by Pacific Rim investors or European interests.

On a global scale, the Japanese banks are ranked among the strongest both in terms of total assets and debt ratings. Of the top 10 banks in the world, six are Japanese-owned and all are triple-A rated. In fact, as one can see from Table 1, Citicorp is outranked by four Japanese banks.

The Japanese commercial banks are not only active in direct construction and permanent mortgage lending, but



also buy commercial properties through affiliated companies. These banks do not own investment properties.

During the past few years, the Japanese have captured a large share of the market for loan guarantees. Lower capital cost, lower fees and excellent long-term debt and commercial paper ratings are reasons contributing to their competitiveness. The Japanese banks have emerged as key participants in mortgage financing for existing and "to be built" commercial properties in the United States. Japan's current short-term prime rate is 3.6 percent and the long-term rate is 5.1 percent. The lower interest rate enables them to arrange yen-dominated financing at the 4 percent to 5 percent range. Thus, notwithstanding the currency exchange risk, the Japanese banks can earn a 2 percent to 3 percent spread based on 8 percent yield rates on U.S. property investments. The Japanese debt capital inflow will undoubtedly increase and this will occur at a greater intensity than in recent years.

In New York City alone, the Japanese have successfully arranged permanent loans and loan guarantees on major office buildings and hotels including the new American Express building, the Marriott Marquis in Times Square, and the recent refinancing of the Chrysler building.

TABLE 1

Top 10 Banks in the World Ranked by Total Assets ($ Billions)

RANK	BANK	COUNTRY	ASSETS (12/31/85)	LONG-TERM DEBT
1.	Dai-Ichi Kangyo Bank Ltd.	Japan	$158.3	Aaa
2.	Fuji Bank Ltd.	Japan	142.7	Aaa
3.	Sumitomo Bank Ltd.	Japan	136.0	Aaa
4.	Mitsubishi Bank Ltd.	Japan	133.4	Aaa
5.	Citibank, NA	U.S.	129.5	Aa1
6.	Banque Nationale de Paris	France	123.8	Aaa
7.	Credit Agricole Mutual	France	123.6	—
8.	Sanwa Bank Ltd.	Japan	123.5	Aaa
9.	Credit Lyonnais	France	112.1	Aaa
10.	Norinchukin Bank	Japan	106.3	Aaa

Source: American Banker

Japanese banks' aggressive bidding and pricing policy have enabled them to outbid U.S. lenders for the mega-real estate projects. Rates on construction and permanent loans are usually ¼ to ½ point lower than those of U.S. banks. On a larger loan stretching over a seven- to ten-year period, a ¼ point differential can be a substantial savings for the borrower or developer.

The entry of foreign investors is certainly not limited to Japanese groups. Westfield holdings, Australia's largest shopping center developer, recently acquired three R.H. Macy's department stores for $364 million. In a separate transaction, Hooker acquired Allied Stores Corp.'s Bonwit Teller chain for $101 million and announced plans to expand the number of stores in five years from 13 to 28. Diversification has been Hooker's core strategy in the United States. Hooker's U.S. activity has grown to 30 percent of its overall profit and that is expected to increase to 50 percent in the next two years.

The buyout of American real estate firms by foreigners is becoming more prevalent. This has not yet occurred on any great extent, but it appears that the momentum toward this is intensifying.

The U.S. real estate industry stands to benefit more than to lose by the entry of offshore investors. Unlike the manufacturing and garment industry, real estate can only be produced here in the United States. Because this product is immovable, it clearly gives real estate an advantage over other products and services.

We are rapidly approaching an era characterized as the globalization of real estate, where real estate development and investment in this country reaches out worldwide. □

John F. Tsui is president of New York-based Peninsula Realty Company, which conducts real estate appraisals of hotels, office buildings, and shopping centers, and is engaged in the placement of equity and mortgage financing through offshore institutions. He is the founder and managing director of the Asian Real Estate Association

Market *continued from page 139*

that compose the CMO. In a basic CMO, there are typically four tranches (or bond classes). Bonds in the first three tranches receive their coupon payments while the fourth tranche accrues interest. Principal paydown will go only to the designated first tranche. The remaining classes will receive principal in sequential order after the first tranche has been retired. The sequential principal paydowns will continue until the last tranche is paid off. CMOs are structured to generate sufficient cash flows to ensure the retirement of all the bonds.

FR CMO product features

Essentially, the FR CMO is a hybrid of the fixed-rate CMO and the Eurodollar floating rate note (EFRN). The EFRN is a debt instrument that is issued in the dollar denominated sector of the Eurobond market. The EFRN is one of several different types of floating rate notes with a coupon or interest rate that adjusts periodically due to changes in a base rate. Presently, EFRNs account for more than 50 percent of all new Eurodollar debt.

TABLE 1

FR CMO Highlights January–June 1987

	Percentage of Transactions	
▪ 30-year mortgages as underlying collateral	92%	
▪ 15-year mortgages as underlying collateral	8%	
▪ Placement of FR tranche		
1	63%	
2	35%	
Other	2%	
▪ Index		
1-month LIBOR	8%	
3-month LIBOR	92%	
▪ Quarterly pay bond	98%	
non-quarterly	2%	
▪ Average cap	12%	
▪ Average margin	56	basis points
▪ Average maturity	325	months

TABLE 2

FR CMO Collateral Breakdown
Jan–June 1987 (b = billions of $)

Whole Loans	$.048b	(0.5%)
Fannie Mae	$2.1b	(20.1%)
Freddie Mac	$4.1b	(39.2%)
Ginnie Mae	$4.2b	(40.2%)

The key components incorporated into the fixed-rate CMO to make it look and act similar to the EFRN are the following:

- The bond coupon rate is indexed to the London Interbank Offered Rate (LIBOR). LIBOR is a short-term rate for period deposits. LIBOR is used as the reference rate because it represents the equilibrium price for global deposits. The LIBOR index is determined two days before the reset date by the CMO bond trustee who surveys four reference banks, averages the quoted rates and rounds to the nearest 1/16 of 1.0 percent.

> **While the FR CMO is a hybrid structure, it is primarily a mortgage instrument. As a result, there are several important distinctions between EFRNs and FR CMOs.**

- The LIBOR index and the bond payment frequency are usually matched. For example, a three-month LIBOR index will support a quarterly pay bond. Recently, there have been FR CMO transactions where the index and the reset frequency do not correspond: the monthly LIBOR index has been linked to a quarterly bond coupon reset frequency.
- The FR CMO coupons are reset at a fixed spread over the index rate. The range for the spreads has been 35 to 70 basis points. The spread is a function of the average life of the collateral, the type of collateral (Table 2), the credit quality of the issuer, the cap structure and the general financial market conditions.
- A FR CMO class must be capped at some rate due to the investment grading standards of the rating agencies. The rating agencies require a cap because the floating rate tranche is supported only by payments from fixed-rate mortgages. The cap ensures that the cash flows from the collateral will always be sufficient to meet the bond's interest payments. There are two types of FR CMO cap structures: step caps which are set initially and increase by a small increment each year and lifetime caps which are effective from issue through the life of the instrument. Lifetime caps represent the majority of issuances, with caps currently ranging from 11 percent to 13 percent.
- The FR CMO principal paydown structure may be sequential or in a pattern other than consecutive stated maturities. Frequently, the simultaneous pay floater class structure is utilized where principal is paid on two or more classes at a specified ratio. The ratio may be in unequal portions which can dramatically affect the investment returns of the bonds. For example, a FR CMO low coupon tranche that receives a large percentage of the principal payment will provide a superior return performance over a comparable discount mortgage-backed security under decreasing interest rates.

Differences: EFRNs and FR CMOs

While the FR CMO is a hybrid structure, it is primarily a mortgage instrument. As a result, there are several important distinctions between EFRNs and FR CMOs:

EFRNs do not have supporting collateral and for this reason do not depend on cash flows from any specific assets. FR CMOs are supported by the cash flows of mortgages and, therefore, are tied to the mortgage market. The investor purchases a bond that is driven by the rate of prepayments. Although FR CMOs are typically priced at or close to par, the rate of prepayments can alter the average life of the bonds. Average life calculations are critical in determining the yield used for pricing.

EFRNs pay interest immediately at the end period. A standard feature in a CMO is a delay in the timing of the bond's interest payments. The delay factor is a function of when payments from the collateral are passed through to the investor. The effect of the delay is that interest is not accruing between the end of the coupon period and the actual payment date. Recently, FR CMOs have been structured to eliminate the delay problem. In 1987, there has been only one FR CMO transaction where delay was included in the structure. The removal of the delay has been accomplished by various structural enhancements: the establishment of a reserve, overcollateralization, the use of deferred interest bonds, and the inclusion of premium collateral to support the bonds.

EFRNs use the actual/360-day basis accounting method—The interest accrual method used for mortgages is the standard 12 30-day months. This method eliminates an investor's opportunity to potentially earn an extra five to six days of interest in a calendar year. While a majority of FR CMOs have conformed to the 30/360 accounting system, a few FR CMOs have used the actual days method.

EFRNs are quoted on a yield to maturity basis—The quoted yield convention for FR CMOs is the corporate bond equivalent (CBE). The CBE translates the monthly mortgage cash flows into a yield equivalent for a quarterly semiannual payout.

Issuer's viewpoint

Although issuer's financial objectives vary in structured transactions, the issuers have identified two significant problems concerning fixed-rate CMOs:

- The cost of funds for issuance was too expensive.
- The performance of the fixed-rate residual needed improvement.

The issuer's cost of funds is reflected in the rate that the bond class is sold and the expenses incurred. The FR CMO's issuance cost is lower than the fixed-rate CMO in a positively sloped yield curve environment because it is priced off the LIBOR index which is at the low end of the yield curve. The lower end of the yield curve translates into a higher selling price for the FR CMO and in turn reduces the issuance cost. Table 3 illustrates the bond coupon cost differences between an actual fixed-rate CMO and a FR CMO transaction issued the same day.

TABLE 3

	Fixed-Rate CMO	FR CMO
Weighted Average Coupon	8.48	8.125
Stated Maturity	11/1/02	11/1/03
Average Life	5.40	5.09
Spread	+165 bp off Treasury	+55 bp off LIBOR
CMO Bond Coupon	8.75%	7.61%

A comparison of the fixed-rate CMO with the FR CMO shows a sizable difference in the two transactions—114 basis points (8.75 percent–7.61 percent). From the issuer's standpoint the difference is significant and reduces the return on the transaction.

From January to May 1987, mortgage bankers have issued $2.3 billion publicly offered CMOs and represent the third largest producer behind investment bankers and home builders.

The issuer's other problem with a fixed-rate CMO is the performance of the residual. A residual investment represents any excess cash flow which is not required for retiring the CMO's bond classes. For the issuer the residual is the primary incentive to do a CMO transaction. The sale of the residual, whether in a private placement or as a publicly registered class, determines the profit in a CMO. As a result, the residual must be attractive for investors to purchase it. The projected investment performance of a CMO residual is a function of the underlying collateral, the structural design of the tranches, the administrative expenses during the life of a CMO and the short-term reinvestment rates. Typically, the fixed-rate CMO produces bearish residuals. A bearish residual is at its best when interest rates increase and prepayments decrease because the holder of the residual investment will receive a wider spread for a longer length of time. The bearish residual performs inversely to most fixed income securities which operate optimally in a falling rate environment.

The FR CMO, however, creates a residual investment which is appropriate for investors who seek superior returns and limited downside risk. The FR CMO residual's performance characteristics correspond to whether a structure is a combination of fixed and floating rate tranches or 100 percent floating rate tranches. The majority of FR CMOs' issuances are a combination of fixed and floating rate tranches that generate a residual which exhibits high returns under relatively stable interest rate environments. If there are dramatic shifts in interest rates, the performance of the FR CMO residual declines. As a result of the FR CMO's residual performance, investors are attracted to the opportunity for superior returns if interest rates do not shift upward or downward dramatically. Unlike the bearish fixed-rate residual, a FR CMO residual does not offer the investor substantial upside, but it does produce high returns if interest rates remain within a stable range.

For the issuer who desires to sell the residual in a CMO transaction, the FR CMO presents an important alternative set of cost and performance measures.

Investor's viewpoint

Investors' financial goals cannot be easily categorized. Notwithstanding that value is determined individually, investors have raised two issues regarding the fixed-rate CMO:

- Greater price stability.
- A more flexible liability management product.

Domestic and international investors have had a tendency to shy away from mortgage-backed securities due to the uncertainty of yield and average life. With the development of the fixed-rate CMO, an attempt had been made to provide a limited form of call protection to the investor. The CMO structure generates limited call protection by reducing somewhat the reinvestment risk linked with the early paydown of the underlying mortgages. It does not, however, remove all the pricing risks.

continued

The FR CMO attempts to lessen the pricing risk by linking the bond payments with changes in the level of the underlying index subject to the potential limiting effects of hitting the caps. The pricing protection offered to the investor is a cash flow that is at a market rate. In a bear market, the average life lengthens but the coupon will be reset at a higher rate and the investor will receive greater coupon income. For many investors, this type of cash flow is so important that they prefer the FR CMO bond to the fixed-rate CMO which normally has higher yields.

The second issue for investors is liability management. Many portfolio managers constantly reconstruct their liabilities in an effort to lower their all-in-cost of funds. The FR CMO is attractive for those investors who desire to match their liability payments with an instrument that has a hefty spread (generally 55 basis points) over a cost of funds that parallels LIBOR's movement. The FR CMO presents the investor with an opportunity to arbitrage against their funding costs with limited downside risk. Additionally, if the investor is uncertain or anticipates a rise in interest rates, the FR CMO offers a defensive strategy with an ability to preserve capital and offset other potential fixed income losses. Overall, to the investor with a match funding viewpoint, the FR CMO provides an inherent hedge to their liability stream.

REMIC

The Real Estate Mortgage Investment Conduit (REMIC) legislation did not initially include floating rate instruments as an approved product. Effective June 15, 1987, the Internal Revenue Service (IRS Bulletin 1987-24) established the guidelines for floating rate regular interests. Although FR CMOs have been a sizable percentage of the CMO market prior to the IRS's ruling, more than 60 percent of the CMO issuances since the announcement have been REMIC FR CMOs.

Future

From January to May 1987, mortgage bankers have issued $2.3 billion publicly offered CMOs and represent the third largest producer behind investment bankers and home builders. The mortgage bankers' issuances have been twice the rate of the fourth-place thrifts. This year, CMO production by mortgage banking firms is on track to be another volume record breaker.

The FR CMO, a new derivative of the basic CMO, offers an excellent opportunity for mortgage bankers to issue an arbitrage transaction and elect to sell the residual or retain it for hedging purposes. Recently, Lomas & Nettleton, one of the largest mortgage bankers, brought to market a $100 million arbitrage FR CMO. L & N's FR CMO exemplifies the type of mortgage finance transaction which mortgage bankers will increasingly select to issue because of its lower cost structure and superior residual performance. ☐

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MORTGAGE MARKET TRENDS

Current signs of strength in the industrial sector suggest renewed vigor in the overall economy in the months ahead. Real GNP, after rising at a 2.3 percent annual rate in the second quarter, will probably grow at around a 3 percent annual rate in the third quarter. By year-end and into 1988, the annual growth rate of real GNP could rise above 3 percent in the absence of tightening activities by the Federal Reserve.

A substantial decline in the foreign exchange value of the dollar has dramatically improved the competitive position of U.S. manufacturers, both domestically and overseas, since the third quarter of 1986. For the nine months ending in June, real GNP grew at an average annual rate of 2.7 percent, with increases in real net exports of goods and services accounting for a full 1 percentage point of that growth. During this period, the physical volume of non-farm exports rose at an annual rate of 12 percent, while the volume of non-oil imports increased only at an annual rate of 2½ percent. Although the U.S. merchandise trade deficit was reported to have widened to $15.7 billion in June and $16.5 billion in July, from $14.0 billion in May, these monthly data are extremely volatile. Moreover, these data are neither seasonally adjusted nor do they account for relative changes in prices. It is quite likely that the increased activity noticed in the industrial sector is in large due to a more favorable position of U.S. manufacturers vis-a-vis foreign competition.

Growing economy

Evidence continues to mount that the economy, led by manufacturing, is growing briskly. In August, total nonfarm payroll employment rose by 156,000 following a gain of 296,000 jobs in July. The average monthly increase in jobs for these two months is more than double the average increase for May and June. Furthermore, despite a decline since June of 9,000 jobs in the manufacture of autos, there has been an increase of 86,000 in overall manufacturing employment. Industrial production posted a sharp advance in July, up 0.8 percent, following revised increases of 0.7 percent in May and 0.4 percent in June. Since April, industrial production has increased at an annual rate of 7¾ percent, compared to just under a 3 percent annual rate of growth in the February to April period.

Healthy gains in industrial output can be expected to continue for some time, judging by changes in the current backlog of unfilled orders for durable goods. An increase of 1.4 percent in unfilled durable goods orders in July followed a 1.3 percent increase in June. Unfilled orders for durable goods have increased at over a 15 percent annual rate from March to July.

Even with anticipated cutbacks in third quarter auto production, this allows for further growth in durable goods production in the months ahead.

Consumer spending has shown modest strength in the past few months. After rising at about a 5 percent annual rate in the March to May period, in the May to July period personal expenditures rose at an 11 percent annual rate. Although modest gains in personal income and savings will probably limit the growth of consumer purchases, consumer spending should nevertheless make a contribution to real GNP growth in the near term.

Despite the acceleration of activity in the past few months, inflation has moderated from the pace of earlier this year. Consumer price increases, after averaging over 0.4 percent per month in the first six months of the year, increased only 0.2 percent in July. Moreover, producer prices for finished goods also rose only 0.2 percent in both June and July and were unchanged in August, despite sizeable increases in energy prices in each of these months.

Rates

The positive news on inflation has had little positive effect on interest rates. Fears of future inflation have simmered for several months in the credit markets, and early in September the Federal Reserve raised the discount rate 50 basis points to 6.0 percent, and this was followed by increases in both the prime bank lending rate and the maximum rate on Veterans Administration (VA) guaranteed mortgages. Yields on 30-year government bonds are now around 9½ percent, the highest rate since January 1986, and 2 percentage points above last February's levels. To a large degree, increases in long-term interest rates this year have been associated with weakness in the exchange value of the dollar.

To be sure, increases in rates on 30-year fixed-rate mortgages, currently hovering between 10.8 and 11 percent, have restricted activity in housing markets. From May through July new home sales averaged 650,000 units per month, down 75,000 units from the January to April pace. With further interest rate increases expected over the next 12 to 18 months, stemming partly from Federal Reserve tightening actions to avoid a renewal of inflationary pressures, further decreases in housing market activity seem inevitable.

Gregory D. Luetscher
Economist
September 11, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1987												
FEB	103	76	27	1,838	1,379	459	101	76	25	1,676	1,313	363
MAR	141	107	34	1,730	1,296	434	150	109	41	1,719	1,244	475
APR	159	124	35	1,643	1,275	368	157	117	40	1,598	1,152	446
MAY	158	120	38	1,606	1,197	409	136	104	32	1,493	1,100	393
JUN	165	123	42	1,597	1,183	414	156	118	38	1,517	1,124	393
JUL$_p$	**155**	**120**	**35**	**1,611**	**1,222**	**389**	**141**	**104**	**37**	**1,488**	**1,079**	**409**
1986 TOTAL	1,806	1,263	543				1,769	1,185	584			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
7 MONTHS												
1987	986	746	240				947	701	246			
1986	1,104	767	337				1,075	723	353			
1985	1,014	696	318				1,002	631	371			
1984	1,076	741	335				1,041	685	356			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1987																
FEB	10	14	45	34	291	371	675	501	15	16	43	27	319	388	577	392
MAR	22	24	57	40	296	348	616	470	25	26	60	41	317	335	624	443
APR	26	28	66	40	272	305	665	401	27	32	58	41	290	305	588	415
MAY	28	28	60	37	297	309	623	377	26	28	50	33	274	284	575	360
JUN	29	29	56	43	264	293	604	436	29	29	59	40	276	266	605	370
JUL$_p$	**29**	**29**	**58**	**43**	**288**	**247**	**639**	**437**	**28**	**26**	**49**	**38**	**282**	**252**	**550**	**404**
1986 TOTAL	294	296	733	484					283	290	687	510				
1985 TOTAL	252	240	782	468					260	237	753	484				
7 MONTHS																
1987	159	176	385	266					165	170	360	251				
1986	162	172	470	300					162	168	441	305				
1985	133	132	471	278					147	132	446	277				
1984	106	140	556	275					110	124	516	291				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1987														
FEB	241	59	358	6.1	224.5	108.5	28.4	87.6	1,096	669	427	118	78	40
MAR	325	73	352	6.0	225.9	112.0	27.5	86.4	1,085	669	416	127	86	41
APR	331	72	355	5.9	224.7	112.8	27.0	84.9	1,070	675	395	135	94	41
MAY	346	61	353	6.8	228.2	112.8	26.6	88.8	1,061	670	391	131	94	37
JUN	361	59	360	6.8	221.7	113.5	24.9	83.3	1,062	674	390	147	108	39
JUL$_p$	**n.a.**	**54**	**361**	**6.7**	**221.1**	**115.0**	**24.7**	**81.4**	**1,063**	**681**	**381**	**140**	**99**	**41**
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
7 MONTHS														
1987	n.a.	431										933	648	285
1986	2,048	486										930	629	301
1985	1,832	416										902	612	290
1984	1,761	403										675	494	181

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL Total	TOTAL Mtg. Bankers[9]	TOTAL S&Ls	TOTAL Banks[2]	TOTAL Life Cos.	1-4 UNITS Total	1-4 UNITS Mtg. Bankers[9]	1-4 UNITS S&Ls	1-4 UNITS Banks[2]	1-4 UNITS Life Cos.
1986										
OCT	$56,285	$12,659	$20,760	$19,781	$3,085	$41,901	$11,535	$16,992	$12,985	$389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
DEC	74,941	14,615	26,639	27,478	6,209	47,459	13,148	19,298	14,720	293
1987										
JAN	42,804	9,748	12,888	18,641	1,527	31,421	8,791	10,477	11,932	221
FEB	44,756	10,518	13,128	19,103	2,007	31,486	10,012	10,773	10,534	167
MAR$_p$	**55,498**	**14,311**	**17,994**	**20,960**	**2,233**	**40,433**	**13,876**	**15,061**	**11,357**	**139**
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
3 MONTHS										
1987	143,093	34,577	44,045	58,704	5,767	103,340	32,679	36,311	33,823	527
1986	89,478	20,413	34,180	29,159	5,726	61,093	18,628	26,398	15,493	574
1985	66,722	12,621	26,703	23,026	4,372	42,999	11,594	19,227	11,985	193
1984	65,427	13,947	25,697	22,966	2,817	44,430	13,038	18,977	12,240	175

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
OCT	$3,560	$735	$1,933	$735	$157	$10,824	$389	$1,835	$6,061	$2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
DEC	6,753	919	3,629	1,677	528	20,729	548	3,712	11,081	5,388
1987										
JAN	2,878	529	1,340	877	132	8,545	428	1,111	5,832	1,174
FEB	2,659	222	1,144	1,053	240	10,606	284	1,206	7,516	1,600
MAR$_p$	**2,751**	**71**	**1,421**	**1,004**	**255**	**12,314**	**364**	**1,512**	**8,599**	**1,839**
3 MONTHS										
1987	8,289	822	3,905	2,935	627	31,464	1,076	3,829	21,946	4,613
1986	6,598	709	3,595	1,678	616	21,603	892	4,187	11,988	4,536
1985	5,079	584	2,776	1,307	412	18,644	443	4,700	9,734	3,767
1984	4,798	172	2,729	1,609	288	16,199	737	3,991	9,117	2,354

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
OCT	$43,470	$8,959	$19,202	$12,593	$2,716	$138,510	$17,784	$49,878	$51,605	$19,243
NOV	35,692	8,263	17,111	7,554	2,764	129,903	20,974	48,994	40,726	19,209
DEC	43,851	13,033	19,548	7,979	3,291	124,310	23,189	43,014	41,809	16,298
1987										
JAN	29,161	7,044	13,718	6,674	1,725	116,876	18,703	40,419	41,594	16,160
FEB	34,440	10,941	11,585	9,599	2,315	137,570	20,664	49,401	51,121	16,384
MAR$_p$	**48,848**	**12,078**	**23,671**	**9,974**	**3,125**	**135,835**	**20,110**	**52,366**	**47,241**	**16,118**
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
3 MONTHS										
1987	112,496	30,063	48,974	26,294	7,165					
1986	102,354	30,315	44,607	17,896	9,536					
1985	60,261	9,966	33,988	8,946	7,361					
1984	61,573	12,569	32,604	10,884	5,516					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1987												
FEB	243	153	42	48	167	11,525	90	5,458	44	3,255	33	2,812
MAR	307	190	49	68	247	16,893	148	9,134	60	4,420	39	3,339
APR	285	165	41	79	227	15,768	142	8,947	41	3,021	44	3,800
MAY	216	104	38	74	230	15,838	149	9,265	36	2,622	45	3,951
JUN	212	93	43	76	219	15,501	120	7,502	47	3,424	52	4,575
JUL$_p$	**192**	**88**	**37**	**67**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**41**	**2,979**	**52**	**4,566**
1986 TOTAL	3,283	1,908	452	923	1,852	127,759	921	56,901	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,333	87,485	410	23,964	192	13,046	731	50,475
7 MONTHS												
1987	1,663	913	291	459	n.a.	n.a.	n.a.	n.a.	307	22,439	307	26,605
1986	2,078	1,229	243	536	859	59,617	387	23,957	161	11,547	311	24,113
1985	1,231	490	122	619	675	44,004	159	9,147	94	6,293	422	28,537
1984	1,127	253	121	753	843	54,208	138	7,369	133	8,581	572	38,258

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1987										
FEB	$912	$979	$104,670	$4,691	$8,802	$7,990	$7,961	$7,844	$11,668	$9,692
MAR	2,805	1,435	107,673	4,627	9,385	14,314	9,394	9,145	10,873	10,736
APR	3,208	2,118	112,673	6,997	8,167	12,965	9,777	9,852	15,050	11,934
MAY	1,726	1,718	116,861	7,086	6,730	5,170	7,996	7,768	10,220	3,515
JUN	1,745	1,690	121,270	6,648	n.a.	n.a.	n.a.	n.a.	14,077	4,950
JUL$_p$	**2,373**	**1,569**	**125,461**	**5,842**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
1986 TOTAL	32,987	30,826	—	60,566	106,563	136,179	103,474	102,443	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
7 MONTHS										
1987	13,717	10,855	—	42,254	40,539	48,442	43,078	42,824	n.a.	n.a.
1986	19,441	13,709	—	29,446	35,699	38,958	28,774	27,223	72,846	46,539
1985	12,001	12,797	—	9,726	18,019	19,181	14,468	13,737	33,225	21,747
1984	12,093	10,411	—	6,949	7,527	8,395	6,068	4,739	22,256	17,589

*Year-to-date totals are for five months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1987								
MAR	8.94%	9.19%	9.20%	9.14%	9.09%	8.06%	8.663%	10.24%
APR	10.02	10.11	10.14	9.21	9.09	8.35	9.655	12.08
MAY	10.61	10.44	10.46	9.37	9.27	8.85	10.208	12.65
JUN	10.33	10.29	10.29	9.45	9.38	8.69	9.995	n.a.
JUL	10.38	10.22	10.23	9.44	9.43	8.45	9.773	n.a.
AUG$_p$	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**8.91**	**10.007**	**n.a.**

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1987							
MAR	8.12%	8.25%	8.22%	8.84%	7.75%	5.60%	6.16%
APR	9.06	9.13	9.08	9.51	8.02	5.90	6.45
MAY	9.76	9.62	9.59	10.05	8.61	6.05	6.93
JUN	9.69	9.70	9.65	10.05	8.40	5.99	6.92
JUL	9.62	9.64	9.59	10.17	8.45	5.86	6.65
AUG	**9.79**	**9.73**	**9.7**	**10.37**	**8.76**	**6.14**	**6.71**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1987				
MAR	10	87	100	97
APR	51	104	111	106
MAY	56	115	101	98
JUN	28	129	130	125
JUL	21	117	119	114
AUG	**n.a.**	**103**	**97**	**94**

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity